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FEDERAL-STATE FINANCIAL RELATIONS IN AUSTRALIA. [MEMORANDUM]

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SUMMARY OF MEMORANDUM ON FEDERAL-STATE FINANCIAL RELATIONS IN AUSTRALIA.

1. Financial provisions of the Constitution

The Commonwealth of Australia Act 1901 provided for general subsidies by the Commonwealth to the states for a period of at least ten years, for special subsidies to individual states at the discretion of the Commonwealth Parliament (see section 6 hereof) and for the assumption of state debt by the Commonwealth (by agreement between governments) as a means not of relieving state financesbut of consolidating and simplifying the country's public debt structure; for the important amendment of 1928 with respect to this latter subject, see section 7 hereof.

The provisionsfor general subsidies were contained in sections 87, 89, 90, 93 and 94 of the Constitution, and guaranteed to the states all surplus revenue of the Commonwealth from 1901 to 1910; to ensure that there would be surplus revenue, the Commonwealth was required to return to the states, during this period, not less than three-quarters of its net revenue from customs and excise duties. These were the only federal taxes prior to 1910, and had been the chief source of tax revenue for the states prior to federation.

2. Commonwealth and State finance 1901-10

It is clear that the subsidy-system was the most important feature of federal-state financial relations in the early years after union. The subsidy represented over three-quarters of Commonwealth tax receipts, and was as great as all other revenue of the states exclusive of receipts of railways and other publicly owned business undertakings.

This reliance of the states upon a share of federal revenues did not change. In the fiscal year 1901-2 the Commonwealth payment amounted to 42% of state expenditures (excluding operating expenses of railways, etc.) and in 1909-10 the ratio was 44%.

SURVEY OF RELATIONS IN FEDERAL-STATE FINANCE: [illegible]
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1. Financial Provisions of the Constitution

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2. Commonwealth and State Finance, 1901-10

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Under the Constitution, the Commonwealth had necessarily been given the chief source of government revenue, but its responsibilities, prior to the War, were small. The states had by 1901 reached a stage of development much in advance of that of the constituents of other federal nations at the time of their federation. Most of the functions and responsibilities which attached to the Australian colonies in 1901 were retained by the states after federation. It is not surprising that, in such circumstances, state finances should be dependent upon the Commonwealth as a major source of revenue.

3. Alterations of the financial relationship to 1910.

When the period of guaranteed subsidy came to an end, Commonwealth authorities were not prepared to continue with payments of the same size, or calculated in the same manner. After much discussion, a new system was agreed to by all parties, providing for an annual subsidy to each state of 25 shillings per head of population. It was intended to give security to the states by including this arrangement in the constitution, but the amendment was rejected on referendum in 1909. Further referenda in 1911 on amendments designed to increase the powers and responsibilities of the Commonwealth were likewise rejected. The states were thus left with unabated expenditures and no assurance of sufficient revenues. They became dependent upon the willingness of the Commonwealth to give them sufficient money each year to prevent financial collapse, which was otherwise inevitable. In 1910 the Commonwealth Parliament met the situation by enacting a Surplus Revenue Act whereby the states received the same annual subsidy as had been intended to be provided under the unsuccessful amendment to the constitution. This system continued unchanged until 1927.

4. State finances under the per capita subsidy, 1910-27.

The new subsidy was substantially smaller than the old, and state finances immediately reflected the change, surpluses

in 1901-1910 giving place to deficits from 1910 to 1927. In only two years during the latter period did the states as a group show a surplus. For the period 1910-27 as a whole, aggregate net deficits of the states were £15.5 million; subsidies and special grants from the Commonwealth amounted to £114.5 million, so it appears that the states' own sources of revenue under the constitution were less than their expenditures by £130 million, or an average of about £7,645,000 per annum.

The per capita subsidy might have worked satisfactorily but for the effects of the War. The great rise in prices resulting from the effects of war expenditures in the western world increased the cost of state governments, while the subsidy remained at the former level. The Commonwealth was unable to raise the subsidy during the War and refused to do so afterwards. Another effect of the War was to force the Commonwealth to levy direct taxes on a large scale, thus interfering with the chief source of state revenues. The states meanwhile continued to be responsible for railways, roads, education, and social services generally except old age pensions which had been a federal undertaking since 1909. They were also clothed with exclusive power under the constitution, and charged with the duty according to the Australian conception of their functions, to undertake the development of their lands and resources and the peopling of their territory. These objects were attained at great expense and rather high speed, in the course of which mistakes, mismanagement and extravagance inevitably occurred. Land development, railway extension and construction of irrigation works required large capital expenditures, and subsequent revenues were not sufficient, in many cases, to meet interest on the debt incurred for these purposes.

5. Other features of federal-state financial relations 1910-27

It was evident after the War that some further adjustment of the financial relationship was necessary, but no actual change was made until 1927. Meanwhile, there were a number of developments illustrative both of the unsatisfactory nature of the existing system, and of the expedients by which particular difficulties were met through co-operation between federal and state governments.

The states had large public debts at the time of federation in 1901, amounting to almost £200 million or £53 per capita. By 1928 this had increased to £714 million, or £114 per capita. The Commonwealth had no public borrowings until the War, but by 1920 its debt amounted to £352 million; this increased to £380 million by 1928. Excluding borrowing for war expenditures, it is evident that almost all public debt in Australia is owed by the states, and that the amounts are very large for junior governments in a federation, although railways and other revenue-producing assets support, at least in part, the major portion of the debt. In 1901 about 88% of state public debt was payable abroad; in 1928 the proportion was 58% for the states and 40% for the Commonwealth. Municipal debt, exclusive of that owed to state governments, is comparatively small. In 1934 the debt of the Commonwealth was £393 million, of the states £830 million, of municipalities £68 million, and of semi-governmental public bodies £51 million, a grand total of £1,342 million or £201 per capita.

The states, however, have not since 1911 built up their public debt solely on their own credit. They have been assisted by direct loans from the Commonwealth and by Commonwealth guarantee of state borrowings; since 1929 all public borrowings by the states have been secured by Commonwealth securities, and as a result of the conversion operations in 1931 and subsequent years the proportion of state public debt represented by state

bonds is now comparatively small and continually decreasing.

This mobilization of the credit of all Australia for the benefit of each government is the culmination of a long development which began in 1910 when the Commonwealth Government commenced to issue Australian notes and prohibited further circulation of bank notes; about £22 million of new currency was used to buy new state securities, the difficulties of public borrowing except for war purposes being the chief motive for this method of financing the loan expenditures of the states. In the latter years of the War loans totalling £17 million were made to the states out of the proceeds of Commonwealth loans abroad. Between 1919 and 1924 loans for specific purposes, such as soldiers' settlement, were made to the states to an amount of £39 million, out of the Commonwealth War Loan Fund. From 1924 to 1928 further loans amounted to nearly £70 million; in these cases the Commonwealth raised the funds by special loans on its own credit.

In 1924 and 1925 all Commonwealth and state borrowings were co-ordinated through a voluntary Loan Council; this came to an end late in 1925 when New South Wales withdrew from the scheme.

With respect to taxation, the division of constitutional jurisdiction in Australia is similar to that in Canada. In 1901 indirect taxes (customs and excise)accounted for over 75% of combined Commonwealth and state tax receipts; all states, however, were levying a number of direct taxes and by 1910 these included, for all states, succession duties, land tax, stamp duties, and income tax. The Commonwealth imposed a land tax in 1910 and federal taxes on income, entertainment and inheritances commenced during the war. Total per capita taxation (federal and state combined) rose from £3 in 1901-2 to £10.5 in 1919-20 and £14 in 1927-28. In 1936-37 the figure was £16. Commonwealth taxation amounted to 76% of the total in 1901-2 and 64% in 1927-28. In the case of direct taxation the

Commonwealth receipts were greater than those of the states in 1919-20 but have not been half as great as the states' since 1927; in 1936-37 the proportion was only one-quarter, as a result of rate-reductions by the Commonwealth since balancing its budget in 1931-32.

Duplication of direct taxes was complete by 1916, with the exceptions of motor taxes and stamp duties (other than succession duties); the Commonwealth has not entered these two fields, but does levy a substantial gasoline tax. Controversy over tax-fields accompanied that over the subsidy system prior to 1927; no constitutional or voluntary changes were effected as to the kinds of taxes to be levied by federal and state authorities, but there were two achievements in regard to administrative co-operation. Since 1921 all Western Australia taxes have been collected by the Commonwealth. Since 1923 the state authorities have collected both federal and state income tax in all states except Western Australia.

There have been a number of instances of co-operation between the Commonwealth and the states in pursuit of common objectives. In most cases the Commonwealth's part has consisted in the grant or loan of money, for example, the loans for soldiers' settlement, and for public works. A case of outright grants is the federal aid roads scheme, established on a comprehensive basis in 1926. The Commonwealth made grants of £2 million a year, shared among the states as to three-fifths of the amount in proportion to population, and as to two-fifths in proportion to area. Conditions were imposed, such as that the states must raise an amount equal to three-fourths of the grant, that the grant could be used only for construction and not for maintenance, and that all roads to be constructed with such funds must be approved by Commonwealth authorities. During the depression the requirement of state contribution was dropped, and the federal grant was permitted to be spent on maintenance.

The Commonwealth has assumed responsibility for two interstate railways, largely constructed since federation by the Commonwealth. Total mileage of federal railways open for traffic in 1936 was 2,145 as compared with 24,945 miles of state railways. The Commonwealth also provided the funds for a line connecting New South Wales and Queensland but left ownership and operation to the respective state railway systems.

Irrigation works in the Murray River have been financed jointly by the Commonwealth and the three states affected. A separate administrative body was set up representative of the four governments.

From 1920 to the depression the Commonwealth gave financial assistance to immigration, but each state retained absolute control of the number and kind of immigrants which it would receive. Net immigration ceased soon after 1930. During the decade 1921-30 net immigration amounted to about 305,000 persons, of whom about 215,000 were assisted by Commonwealth grants.

6. <u>Special grants to individual states</u>.

A feature of federal-state financial relations in Australia has been the special grants by the Commonwealth to individual states under section 96 of the Constitution. A general system of subsidies to all states equally has always been maintained; all other direct financial assistance to state budgets has come under the head of special grants. Western Australia has received such annual grants without interruption since 1910, Tasmania since 1912, and South Australia since 1929. The other three states have never received a special grant, although in the three years 1934-35 to 1936-37 there were distributions to all states out of the Commonwealth surplus; these were in addition to the general subsidy, special grants, and roads grants.

The early grants to Western Australia and Tasmania were made on the ground that these states needed special assistance to effect the transition necessitated by federation and loss of

customs revenue. In later years, however, the grants were merely devices to save the recipient states from bankruptcy. No comprehensive treatment of the situation appeared until the Commonwealth Grants Commission was appointed in 1933. This body receives all claims for special grants and recommends to Parliament what grants should be made each year. The grants were considerably increased during the first two years of the Commission and have since been progressively reduced as depression gave way to recovery in Australia.

The grants were necessitated by the evident inability of the claimant states to finance their expenditures out of their own resources. During the period of the per capita subsidy (1910-27) Western Australia's accumulated budget deficits, exclusive of the special grants, came to an amount equivalent to £24.5 per head of population in 1927; the special grants reduced this to £15.7. Tasmania's figure was £10.2, reduced to £2.4 by the special grants. For the other four states combined the figure was £1.6. In the depression years it was not possible for the weaker states to continue with deficits of such size. South Australia joined the claimant states, and the grants of the others were increased. During the period 1927-35 direct Commonwealth assistance to state revenues (i.e. general subsidy and special grants) amounted to 49% of the state's own tax revenues in South Australia, 56% in Western Australia, and 79% in Tasmania, as compared with an average of 30% for the other three states.

The difficulties of the claimant states arise from the limitations of their physical resources, the fact that their chief products must be exported and are subject to world conditions, and the fact that the federal customs tariff has burdened rather than benefited them. Western Australia and South Australia, while possessing a measure of industrial and mining activity, are chiefly dependent on wheat and wool, produced under difficult conditions in semi-arid country, and which

must be sold for export at world prices. Settlement and development have been costly and uncertain of success. Tasmania has been in a depressed condition for many years. Queensland is also a largely non-industrial state, but has received such a large measure of assistance through federal policy designed to make sugar-cane production profitable with white labour, that special grants have not been necessary. The excess cost of sugar in Australia has been estimated at £5 million, or over £5 per head of Queensland's population. There remain Victoria and New South Wales, possessing both the climate and the natural resources conducive to a large population and a high degree of industrialization, given the high federal tariff.

The claimant states base their claims for grants chiefly on the ground of compensation for the burden put upon their citizens by the tariff and interstate free trade. The Grants Commission, while admitting that federal policy is part of the cause of these states' difficulties, refuses to make compensation for the effects of policies adopted by the Commonwealth Parliament. The basis on which the Commission declares grants must be made is that every state in need should be assisted to function with a standard of taxation and expenditure not appreciably below those of other states. The Commission each year examines the finances of all states, with particular reference to taxable capacity, severity of taxation, administrative costs, and scale of social services. The non-claimant states are taken as the standard by which to measure the grant which each claimant state should receive. Virtual equality on a per capita basis is the goal, and this is achieved by making grants sufficient to bring the per capita deficits of the claimant states down to a level not greatly above the average in the other states. The deficit will not be quite as low as the standard, for the claimant states are required to get along with social service expenditures about 6% less

per capita than the other states, and also to impose slightly more severe taxation, but in this case only if the Commission finds that the claimant state in question has in the past been guilty of extravagance or mismanagement contributing to its present difficulties. Such lower scales of expenditure and higher scales of taxation are not an actual condition of the grant, but unless they are put in force it is evident that the deficits of the claimant states, after the special grants have been received, will still be somewhat higher, per capita, than the average of the other states, assuming revenues and expenditures for the year in question correspond with those used as the basis of the Commission's calculations.

7. The Financial Agreement of 1927.

The system of general subsidies established in 1910 came to an end in 1927 when the Commonwealth Parliament repealed the Surplus Revenue Act. Years of discussion and conferences had failed to produce agreement on changes in the existing system. The action of Parliament brought home to the states the fact that they were completely dependent on the Commonwealth, unless they chose to default on their debt, and agreement on a new system was reached at a conference of all governments in July 1927. No attempt was made to deal with the fundamental conditions necessitating large payments by the Commonwealth to the states. The agreement dealt only with financial questions, but a new factor was introduced by making the subsidies hinge upon consolidation of the public debts of Commonwealth and states. Under the Financial Agreement of 1927, ratified by constitutional amendment in 1928 and put into permanent operation by the Commonwealth Parliament in 1929, all existing public debt of the states except treasury bills and overdrafts was assumed by the Commonwealth, the states being bound to indemnify the Commonwealth for any payments of interest or principal on such debt. Instead of the former subsidies which were paid direct to state treasuries, the Commonwealth agreed to pay £7,585,000 annually

for fifty-eight years from July 1, 1927 towards interest on the debt so assumed. This amount is equal to the per capita subsidy which would otherwise have been paid in 1927-28.

In addition, a sinking fund was established, designed to liquidate the states' then existing debts by 1985. The states are required to make an annual contribution to sinking fund of 5s. per £100 principal amount of their debt, and the Commonwealth to contribute 2s. 6d. towards the same sinking fund. With respect to new loans obtained by the states, the Commonwealth and the state concerned must each pay into the sinking fund 5s. per £100 annually for 53 years.

New borrowing by either Commonwealth or states is subject to the control of a Loan Council. Loans approved by the Council are raised by the Commonwealth by sale of Commonwealth bonds, whether the money is for its own use or for a state. The total amount to be raised each year is fixed by majority decision of the Council; allocation of the total among the seven governments may be fixed only by unanimous decision; failing unanimity, the Commonwealth is entitled to one-fifth of the total, and the balance is divided among the states in proportion to their expenditure from loan funds in the preceding five years.

"Temporary" borrowings are excluded from the operation of the Agreement. In December 1930, however, the banks refused to finance the current deficits of the various governments except through Commonwealth treasury bills issued with the approval of the Loan Council. Commonwealth loans for defence purposes, authorized by Parliament, are wholly exempt from the Agreement.

The Loan Council is composed of one representative of each government. The Commonwealth representative has two votes, and also a casting vote. Thus the Commonwealth and any two states, or alternatively any combination of five states, constitute a majority.

The Financial Agreement can be altered only by unanimous dedision of the seven governments, or by amendment of the constitution. The Loan Council appears to be a third manifestation of sovereignty in Australia, as supreme in its sphere as the Commonwealth and the states in theirs. Both the terms of the Financial Agreement, with respect to payment of the principal and interest on public debt and contributions towards sinking funds, and the powers of the Loan Council, severely restrict the former freedom of action of the federal and state governments and legislatures. Under section 105A of the Constitution (constituting the amendment of 1928) the Commonwealth is empowered to enforce the Agreement. What this meant to state sovereignty was discovered in 1932 when New South Wales defaulted on an interest payment. The High Court upheld the right of the Commonwealth government, when duly authorized by Parliament, to attach the state's revenues and bank accounts, force taxpayers to pay their state taxes to federal officers, and compel state officers to pay over state monies to the federal authorities.

At the same time borrowing has no doubt been made cheaper by the fact that all governments now borrow on the credit of Australia as a whole. This is of particular benefit to the weaker states, the amount and cost of whose borrowing is not affected by the state of their own finances. Some states, of course, will be unable to borrow as much as they want, or as they would be able to borrow were it not for the existence of the Loan Council. It would seem, however, that such states could circumvent the Agreement by setting up autonomous bodies to operate state enterprises, and have such bodies borrow in their own name. Whether lenders could be found in the case of a flagrant attempt to overcome the restrictive powers of the Loan Council by this indirect means, has not yet been put to the test. There is also no control, under the Agreement, over borrowing by a state within its own boundaries. Possibly state

banks, savings banks, insurance companies and other local investment-institutions could, if necessary, be coerced into lending to a state determined to exceed the limit set on borrowing by the Loan Council, but it is doubtful if, except in extraordinary circumstances, the amounts so obtainable would make the attempt worth while.

8. Australian policy in the depression.

(1) The Australian economy prior to the depression. Australia experienced great prosperity during the five years 1924-25 to 1928-29. This prosperity depended essentially on large volume of exports, high export prices, and large annual borrowings from abroad. Income from abroad (proceeds of exports and loans) amounted to about one-quarter of national income; more important than its absolute amount was the fact that it determined the pace and status of the entire economy. Tariffs and wages were high. The country was extremely vulnerable to any unfavourable change in world conditions, more particularly as large government expenditures on public works concealed an important lack of profitable employment for unskilled labour.

(2) The impact of the crisis. This vulnerability brought a sudden crisis with the first onset of the world depression. The cessation of foreign lending in 1929 left government finances and the balance of payments in a precarious position; the final blow came with the collapse of wool prices in the autumn, and of wheat prices shortly afterwards. The index of export prices, basis average 1925-26 to 1928-29 as 100, fell to 74 in 1929-30 and 58 in 1929-31, while the index of import prices held above 90. Import prices nevertheless fell sufficiently to accentuate the overvaluation of the currency and assist in maintaining the volume of imports for nearly two years after exports began to fall off. When it came, the fall in imports was drastic, with consequent severe restriction of real national income. The initial loss was felt particularly by export industries, notably

wheat-farmers and sheep graziers. When government public works were perforce abandoned, unemployment rose rapidly, and industrial labour was further affected as domestic production declined. Combined government deficits rose from £5 million in 1928-29 to £10 million in 1929-30 and £26 million in 1930-31. The deficit forecast for 1931-32, prior to the adoption of the Premiers' Plan, was £39 million. Currency depreciation was inevitable, in view of the fall in exports and the disappearance of the large sums formerly borrowed abroad each year. Until January 1931, however, depreciation was resisted by gold exports and use of foreign exchange reserves.

(3) Depression policy 1929-31. In 1929-30 the country's economic difficulties were met by higher tariffs and gold exports, which did little to offset the fundamental factors at work. Wages and government expenditures were maintained at previous levels. An attempt was made to increase exports by encouraging production of wheat and wool. Wheat acreage jumped 20% in response to a government offer of 4s. a bushel, which however was defeated in the Senate. Production in 1930 was 70% better than in 1929, but the further fall in price completely offset this. Unemployment continued to rise. Gold and exchange reserves approached exhaustion.

In 1930-31 repudiation and inflation were much discussed. The Commonwealth government and the labour party generally opposed wage cuts and reductions in government expenditures, and came to be proponents of currency and credit expansion. Attempts in this direction met defeat in the Senate. The Commonwealth Bank did not favour expansion, and financial opinion generally desired reductions in wages and public expenditure. Economists advocated both currency depreciation and wage cuts, as well as expansion of central bank credit. The "battle of the plans" was waged for many months as intergovernmental conferences and Loan Council meetings sought agreement on positive remedial action.

In January 1931 two important developments occurred. The Bank of New South Wales took the initiative in abandoning the attempt to maintain the Australian pound at near-parity with sterling; by the end of the month the exchange rates were £130 Australian to £100 sterling, at which point it remained until December. Secondly, the Commonwealth Arbitration Court decreed a 10% reduction in real wages, a reduction shortly applied directly to about 400,000 workers and eventually indirectly to about one-half of Australian wage-earners.

Government finances continued to deteriorate. In February a committee of the Loan Council recommended drastic reductions in public expenditure in order to balance budgets. This was rejected by the Commonwealth government, which proposed a plan involving a smaller measure of economies and the financing of public works by new currency or expanded central bank credit. The New South Wales Premier demanded reduction of interest on all public debt to 3%; this was rejected by the other governments and was unable to pass the state Senate; the actions of the state government (including default on an overseas interest payment in April, which the Commonwealth made good) precipitated a flight of capital and suspension of the state savings bank, and served to show the country what might occur if some positive policy were not adopted.

In April the Chairman of the Commonwealth Bank notified the Loan Council that the Bank would cease to lend money to the governments when total advances reached £50 million; the effect of this was that loans would cease by the end of June. The senate rejected the government's monetary legislation. In the face of this grave impasse the Commonwealth government sought once more, this time successfully, to achieve agreement of all governments on some plan for rehabilitating public finances. The initiative had come from the Loan Council which on April 25th declared that budgets could not be balanced immediately, but

that steps should be taken to achieve balance by 1933-34; by a majority decision the Council appointed a committee to prepare a plan to such end; this committee co-opted four prominent economists and five state Under-Treasurers, whose report was placed before the Premiers' Conference convened in June by the Commonwealth prime minister. The sub-committee's report, with some small changes, was adopted by the conference as a programme of action, and as such became known as the Premiers' Plan.

(4) The Premiers' Plan. The Premiers' Plan was primarily concerned with public finance. Total deficits of the seven governments for 1931-32 were forecast at £39 million unless revenues were increased and expenditures reduced. There was no great optimism with respect to increasing revenues; the Plan required the Commonwealth to increase its rates of income tax, sales tax, and primage duty (a surcharge on imports) with a view to raising an additional £8 million. It was expected that one or two states might increase taxation, beyond the depression increases already in force, but this was not part of the formal Plan. With respect to expenditures, all governments agreed to make reductions averaging 20%, as compared with 1929-30, in all adjustable expenditure. These measures still left large estimated deficits; to reduce deficits to a manageable amount, and as an off-set to the wage reductions which would be necessary under the foregoing provision, agreement was finally reached that interest on all internal public debt should be reduced by 22½%, by means of a "voluntary" conversion operation; it was clearly understood that if conversion were not effected voluntarily, other steps would be taken to achieve the same end. Finally, all states agreed to pass legislation reducing interest on mortgages, and the banks agreed to reduce interest rates on deposits and advances. The Plan was declared an indivisible whole, and was adopted unanimously by the conference, which included in its later stages the leader and deputy-leader of the

federal opposition. Shortly after adoption of the Plan, state opposition leaders met and gave it unanimous support. Institutions holding government bonds agreed in advance to conversion. The leader of the opposition and the chairman of the Commonwealth Bank agreed to act with the Prime Minister to direct the conversion campaign.

(5) Implementation of the Premiers' Plan and other aspects of Australian recovery.

(a) Interest reductions

The conversion loan, based on a vigorous patriotic campaign, was a great success; holders of 91% of the outstanding internal debt of £558 million expressed assent to conversion, and holders of only 3% expressed dissent. The gross annual savings to government budgets (average interest rate reduced from 5¼% to slightly over 4%) were about £6.5 million, of which about £1 million was passed on to local bodies, settlers etc, who had received loans from the states. Subsequently, after Australian credit had improved with the success of the plan for controlling deficits, large conversion loans were floated in London with respect to sterling debt. By June 1936 the average overseas interest rate had been reduced from 5.05% to 3.42%, giving annual savings, including exchange, of about £4 million.

Private debtors received relief through reduction of mortgage interest by 22½% in all states; this included corporation debentures and, in three states, municipal bonds. New South Wales also reduced dividends on preference shares and all interest payments by 22½%, and abolished the personal covenants in mortgages. All states passed debt adjustment acts whereby a moratorium was imposed on farm debt unless creditors made satisfactory adjustments. All states also passed general moratorium legislation available to debtors unable to maintain payments of interest or principal because of circumstances beyond their control. Victoria and New South Wales reduced rents by 22½%.

Bank interest rates were reduced gradually, for the most part voluntarily in conformity with the Plan, during 1931-32. Subsequently further reductions were made as the banks sought outlets for surplus funds.

The conversion issues were quoted below par after flotation, but the restoration of confidence was rapid and by September 1932 the average yield to maturity of all internal issues at market prices was down to 4.1% as compared with 13% in June 1931. Government bonds continued to appreciate until September 1934, when the average effective yeild was 3.2%. Municipal bonds followed a similar trend; less than one per cent of municipal debt went into default.

(b) Restoration of budget equilibrium

The estimated deficits of all governments for 1931-32 were reduced from £39 million prior to the Plan, to £13 million under the Plan as revised in September 1931. The actual result for the year 1931-32 was £19.5 million, the excess being chiefly in one State, New South Wales. The following year the states' deficits amounted to £9 million, while the Commonwealth had a surplus of £4 million. It was decided to effect no further economies but allow the states' deficits to be overcome by increased revenues in the normal course of improving economic conditions, while the Commonwealth reduced taxation with a view to stimulating business.

In the achievement of budget control, expenditures on business undertakings, general administration and roads in 1931-32 were from 15% (New South Wales) to 29% (South Australia) less than similar expenditures in 1929-30, and in 1932-33 still further economies were effected. Reduction in debt charges have already been described. Increased taxation was also imposed, chiefly in the form of wage taxes and special income taxes, usually denominated "unemployment relief taxes". Unemployment relief was financed from revenue only in part;

after 1931-32 expenditures from loan funds for relief works increased and direct relief expenditures decreased, the effect being to give considerable assistance to current budgets. The Commonwealth government's position was greatly eased by suspension (1931-32 to date)of interest and amortization payments on war debt owed to the British government, the annual saving being about £7 million.

(c) Balance of payments.

Recovery in the trade balance seems to have been accelerated by the currency depreciation in January 1931, and by that which occurred automatically in September 1931 when Great Britain went off gold, the Australian pound having been pegged to the pound sterling since January. A large increase in volume of exports due to favourable agricultural production assisted in restoring equilibrium in current payments,as did suspension of the war debt payment already mentioned and the increases in the tariff. Prior to the depression, Australia had had for some years an "unfavourable" trade balance, which, though small, was only rendered possible, in conjunction with large invisible imports, by the continuation of overseas borrowing. With the cessation of such borrowing a positive trade balance had to be achieved, and this at a time of a greatly decreased ratio of export prices to import prices. Thanks to the influences mentioned, a negative trade balance of £41 million in 1929-30 was converted into positive balances of £16 million in 1930-31 and £33 million in 1931-32. In the latter year the value of imports was only 29% of the average of the years 1925-26 to 1928-29; in 1931-32 the figure was 38% and in 1934-35 it was 48%. (All figures refer to values in sterling).

(d) Wages.

As in other countries the average real wages of male workers who remained in full employment did not decline appreciably during the depression. The Commonwealth Arbitration Court's

awards, enforcing a 10 per cent reduction in real wages, affected only about one-quarter of all workers. Another quarter, according to the Court's estimates, likewise had the same reduction; for the remainder, as a result of state tribunals not enforcing wage reductions as great as the decline in prices, average real wages apparently increased. For all workers average real wages were slightly higher, from 1930 onwards, than the average of the years 1926-29. Average nominal wages declined to 81% of the 1926-29 average in 1933, the chief declines being in 1931 and 1932.

(e) Unemployment relief.

The ratio of unemployed to total workers, according to trade union returns, was 11% in 1929 and rose to 27% in 1931 and 29% in 1932, thereafter declining almost uniformly each year to 9% in 1937. Cessation of public works when loans could not be floated was a large contributing factor in the earlier years.

Unemployment relief to the end of 1930-31 was largely in the form of sustenance payments, but thereafter work relief played an increasingly important part in Australian policy. All unemployment relief was almost entirely the responsibility of the states. South Australia engaged in no relief works, confining itself to direct relief; Queensland, at the other extreme, appears to have largely avoided the dole and spent large sums on works schemes; this was the only state with unemployment insurance.

Work relief was in large part rationed among all unemployed capable of such work. Much of the work was of the same general character as the public works undertaken prior to the depression. It was financed in part from "revenue" (in the earlier years of the depression this meant from bank loans to cover current deficits) and in part from loan funds. Total relief expenditures by the states for the six years 1930-31 to 1935-36 were approximately £97 million, according to the annual

Labour Reports of the Commonwealth government and a special report by the chief insurance officer of the United Kingdom department of labour advising the Commonwealth government with respect to a scheme for unemployment insurance. Total cost of relief works was £48 million from loan and £16 million from revenue; direct relief amounted to £33 million.

Federal contributions to unemployment relief were comparatively small, in no year exceeding £2 million. Commonwealth public works were held to a minimum for several years. The Commonwealth, however, greatly increased its bonuses to agriculture during the depression, particularly in the four years 1932-33 to 1935-36 when "relief to primary producers" amounted to £16 million, of which £14.4 million went to wheat farmers.

(f) Assistance to agriculture.

As in Canada, agriculture generally and particularly producers of staple commodities (in the case of Australia, wheat and wool) suffered earlier and longer and to a greater extent than any other section of the community. The first relief came with currency depreciation in 1931, followed by wage and interest reductions. Despite this help, from 1932 until the middle of 1935, according to Professor Giblin's estimate, the ratio of farm income to farm costs remained at about 75% of the average level of 1924-29. An even lower figure would have resulted if agriculture had been left completely at the mercy of economic conditions. Butter producers received some protection through the tariff fixed at 6d per lb. in 1927, which enabled the industry to fix domestic prices and subsidize exports. Sugar producers benefited greatly from the fixed-price system, the domestic prices of raw and refined sugar being maintained unchanged from 1925 to 1932; in the latter year prices were reduced by 11%. Export prices of course, fell rapidly and severely. Wool and meat producers received no direct assistance, except meat producers through the Ottawa Agreements of 1932. Wheat growers were subsidized from 1931-32 to 1935-36 by "relief" payments, really a straight bounty, amounting to £13.8 million;

amounting to £13.8 million; there was also drought relief of £0.6 million in 1934-35.

The states all passed debt adjustment acts designed to keep farmers on the land unless hopelessly indebted. In 1935 the Commonwealth made provision for loans to the states up to £12 million, to assist in composition of farmers' debts.

(g) Annual value of material production

Taking the average of the years 1925-26 to 1928-29 as 100, the value of primary production measured in Australian currency declined to a low point of 68 in 1931-32 and rose to 85 by 1935-36. Net value of manufactures fell to 69 in 1931-32 and rose to 101 in 1935-36. Manufacturing was considerably higher than primary production, in relation to the respective pre-depression averages, in five of the eight years 1928-29 to 1935-36. In the other years (1930-31, 1931-32 and 1933-34) the ratios were about equal.

Total primary and secondary production per head of population declined to 65 in 1931-32 and rose to 83 by 1935-36; measured in purchasing power, the low point was 75 in 1931-32 and in 1935-36 the figure was 101. Gross value irrespective of population increase, but adjusted to price changes, had recovered to the pre-depression level by 1934-35. This rapid recovery, in the face of continued low export prices, reflects increased volume of primary production and, more important, a considerable expansion of industrial activity, which would seem to have reached pre-depression volume as early as 1934. Currency depreciation, by checking imports, was of material assistance in this development as were the 20% reduction in nominal wages and marked improvement in technical efficiency.

(h) Monetary policy

Exchange depreciation in Australia came rather by force of events than by deliberate policy. The action of the banks in January 1931 was followed by a period of eleven months in which, by agreement, the rate was maintained at £130 Australian

to £100 sterling. In December the Commonwealth Bank fixed a rate of 125 at which it would buy and sell freely, and there has been no subsequent change.

Internal monetary policy was not directed towards any marked departure from the normal processes of depression and recovery. There was no expansion of currency other than an increase consequent upon surrender of gold by the trading banks. The required gold reserve against note issue was reduced from 25% to 15% in June 1931, not with a view to expanding currency but in order to make possible further gold exports if necessary to ensure exchange stability. The reserve was to be restored to 25% over a period of four years. In May 1932 further legislation authorized holding the reserve in sterling instead of gold, and virtually all the gold in the country had been exported by June 1933. Since then the annual production of gold has been entirely exported.

Expansion of central bank credit was not viewed with favour, and such expansion as occurred resulted rather from the fiscal needs of governments than from monetary policy. In 1930-31 and 1931-32 it was not possible to float long-term loans abroad or at home. Current deficits had to be financed by bank loans. In December 1930 the banks decided that all future loans must be approved by the Loan Council, and that they must be secured by Commonwealth treasury bills. From then to the end of June 1931 the Commonwealth Bank had to purchase nearly all the bills issued, the trading banks showing no desire for them. In April 1931 the Commonwealth Bank declared it would not allow its loans to go beyond an amount which it was evident would be reached by June. With the adoption of the Premiers' Plan, however, facilities were once more available for financing deficits. The direct expansion of the credit base through purchase of treasury bills by the Commonwealth Bank came to an end when the latter announced it would guarantee the bills and

discount them on demand at the face rate, because the trading banks thereupon commenced to purchase all new issues, until the peak amount of about £50 million of total bills outstanding was reached in September 1932. Under the new conditions, the bills were the equivalent of cash for the banks, so that the effect on the credit base was virtually the same as if the Commonwealth Bank had continued to purchase the bills. Thus, by means of government deficits financed as outlined above, bank cash was increased, and the trading banks' liquidity restored almost as suddenly as it was impaired in 1929 and 1930 through gold exports and depletion of London funds. The Royal Commission on Monetary and Banking Systems in Australia (1937) found that as a result of this development "the banks soon removed their restrictions on new lending" (page 93 of Report).

Commencing in November 1932 the Loan Council and the Commonwealth Bank agreed to fund treasury bills into long-term issues, now possible once more, to at least the same extent as new issues of treasury bills. Since then there have been only seasonal changes in the total of such bills outstanding.

FEDERAL-STATE FINANCIAL RELATIONS IN AUSTRALIA

CONTENTS

1. INTRODUCTORY - THE FINANCIAL PROVISIONS OF THE CONSTITUTION.

The financial relations between the Commonwealth and the states have always been at the heart of federal problems in Australia. There has been no minorities problem in the sense in which the term is understood in Canada -- no political cleavages along lines of race, religion, education or language. The central and local governments have had a much sharper differentiation of function. Insofar as the central government has had anything to do with matters which are in any degree within state powers, the nexus has been chiefly financial rather than constitutional or administrative. The chief governmental functions of the Commonwealth even today are, on the one hand, management of posts and telegraphs, of so-called transcontinental railways which comprise but a fraction of total railway mileage, of the territories, and the defence of the country; for the rest, it collects taxes, protects secondary industry, pays bounties to certain primary industries, pays interest on the war debt, pays old age and invalid pensions, and pays large sums to the states. Land policy, unemployment relief, railways, harbours, roads, education, all social services except old-age pensions, development and settlement of the country, and even immigration, have been left almost entirely to the states, subject only to the payment or loan of money by the Commonwealth to assist such state activities.

The importance of the financial question in the constitution and in the working of federation in Australia no doubt arose from the circumstances in which federation occurred-- which circumstances resulted in the central government being for some years nothing more than a joint fiscal agent for the several states -- and from the refusal of the people to endorse constitutional amendments designed to alter the division of powers and responsibilities originally established.

Federation in Australia came late in the development of modern nations. The Australian states in 1901 were well-established separate entities, each possessing most of the attributes of nationhood then common among the self-governing British colonies. With respect to internal government they had all assumed not only the functions and responsibilities regarded at that date as within the proper sphere of government, but had also entered upon a number of activities which in other countries were still largely confided to private business. As a result, their public debt was relatively very high, and though over half of it was supported by assets which in prosperous times were more than able to meet their debt charges, state finances were also by such fact the more vulnerable in times of business depression. The omission, in the federal scheme, to transfer to the central authority any of such undertakings except the post office (including telephones and telegraphs) has since been the largest single factor in the weakness of state finances, and more particularly from the post-war depression onwards.

The second outstanding feature of state finances was the very great dependence upon revenue from customs and excise duties, which necessarily had to be transferred to the central government in any form of federation. In fact, the establishment of interstate free trade was the strongest argument in the fifty years of discussion of union proposals prior to federation. Since the essence of a federation is the existence of two-fold sovereignty, the logical course seemingly would have been to ensure, in the constitutional structure, that the states would retain and the Commonwealth would be given such responsibilities and powers as would result in each case in a roughly equal balance of probable revenues and expenditures. Recent history would indicate that such an objective cannot be attained, on a fixed and permanent basis, in any federal state, but in Australia

it was not even initially attempted, though apparently there was some belief that such a balance might be achieved after a transition period of ten years. There was, however, no indication in the constitution of how this might be brought about, and the events of 1901-1910, as pointed out in the concluding part of the following section, were such as effectively to preclude any such development in Australia, unless by some radical revision of the entire division of constitutional powers, which has never received popular support.

The extent of the change in public finance created by federation may be judged from the fact that in the fiscal year 1901-2 Commonwealth customs and excise revenue, which was certainly no greater than the combined revenue of the six states from the same source prior to federation, was over three times as great as the revenue of all states from taxation, and 25% greater than total state revenue from all sources other than state business undertakings and public services, and that 83% of such Commonwealth revenue was returned to the states, as a divisible surplus needed to meet state deficits, in accordance with the constitution.

It was, of course, realized in Australia when the federal constitution was being drafted, that the revenues of the new federal government would exceed its requirements, and that the converse would apply to the states. The familiar federal problem of inequality of resources and responsibilities was thus envisaged, but all its implications were not developed. The solution adopted was, not to attempt to equate "supply and demand" in advance, but to provide that all excess Commonwealth revenue should be returned to the state whose people had furnished it. Instead of what is now usually regarded as the equitable principle of redistribution, usually implying a benefit to the less favoured sections of a federal, or for that matter

a unitary, state at the expense of the more favoured, the method adopted in Australia was essentially reimbursement closely akin to repayment of taxes paid by mistake -- a particularist rather than a centralist device.

The actual clause agreed upon at the final constitutional convention in Melbourne in 1898, devised to harmonize the primary objective of interstate free trade with the strong separatist feeling in the states, provided that three-fourths of Commonwealth net revenue from customs and excise should be returned to the states. A further conflict, however, caused this to be changed.

Up to then the tariffs of the various states had been almost entirely for revenue, not for protection, (save in Victoria) but industrial development had begun, particularly in the eastern states, and signs were not wanting that, as later proved to be the case, the tariff under the Commonwealth would become an instrument of protection to industry. Free-traders felt that the victory of protection would be almost automatic if the Commonwealth were forced by the constitution to raise four times as much customs revenue as it needed for its own purposes. Ultimately a compromise was reached at the Premiers' Conference at Melbourne in January 1899. By the so-called "Braddon Clause" (sec. 87) the payments of customs revenue to the states were limited to 10 years, and thereafter were to be subject to repeal by the Commonwealth Parliament itself, and in addition express power was given to the Commonwealth (sec. 96) to make grants of assistance to any state during the first ten years and thereafter until Parliament otherwise provided.

The provision for payment to the states of a share of Commonwealth revenues was of the first importance in the whole federal scheme and in obtaining assent of the states to enter a union.

Sections 89, 93, and 94 of the constitution provided that <u>all</u> surplus Commonwealth revenue should be paid over to the several states, and there is no doubt that this feature was regarded by the states as fundamental, which only makes the more remarkable their acquiescence in the limitation to ten years of the only constitutional guarantee of a specific proportion of federal revenues. For sections 89, 93 and 94 do not ensure that there will be any payment to the states -- they only operate in case of a surplus, if any. Section 87 was needed to ensure that there would be a surplus, or at any rate that there would be a payment to the states whether on book-keeping principles there was a surplus or not. By this section, the Commonwealth was forbidden, but only for ten years after federation and thereafter until Parliament should otherwise provide, from using for its own purposes more than one-fourth of its net revenues from duties of customs and excise. The balance was, "in accordance with this constitution", either to be paid to the several States or applied towards the payment of interest on debts of the states taken over by the Commonwealth. (No such debts were in fact taken over until 1929).

Section 87, however, did not provide what the payment to each individual state should be. In Australia, intergovernmental payments (for other than value received) have always been from the central federal body to the local governments. A question which arises in all such cases is whether such payments are to be made by way of a general distribution to all states, either (a) in proportion to their inhabitants' contribution to federal revenues or (b) on some general basis such as proportionate population, both of which methods deal essentially with the position of the federation vis-a-vis the whole of its constituents, or whether they are to be separate payments to particular states upon some equitable but necessarily unequal basis, that is, in effect constituting

a redistribution between states, an indirect contribution from states more favoured (whether by nature, or as a result of the provisions of the constitution, or through the operation of federal policy) to those less favoured. The method adopted in the Australian constitution for the first five years of federation (sections 89 and 93) comes under the first category, although the Commonwealth Parliament was given power (section 94) after the first five years to alter the basis of distribution, and also, at any time, to make special grants to any state.

Sections 89 and 90 provided that until five years after the imposition of uniform duties of customs (that is, as the event was, until October 8, 1906), all surplus revenue -- which was read to include the payments required by section 87 -- should be paid to the several states in the manner usually described as the "book-keeping system". Each state was to be credited with revenues collected in respect of that state (after adjustment for trans-shipment of imported goods from the State of entry to the state of consumption), and to be debited with Commonwealth expenditures in that state on government departments transferred to the Commonwealth by that State under the constitution, and with a proportion, in accordance with population, of all new Commonwealth expenditures, that is, expenditures on other than transferred departments. The credit balance was then to be paid over to the state as its share of surplus Commonwealth revenue.

The obvious difficulty that would occur if the Commonwealth's actual surplus were less than three-fourths of net customs and excise revenue, did not in fact arise until the last year of the period; with that exception, throughout the ten years' operation of the Braddon Clause the Commonwealth surplus was equal to or greater than the required payment under section 87.

As between states, however, the situation was different. Queensland, for example, received less than three-quarters of net customs and excise collections allocable to it in six out of the ten years, and in the ten-year period as a whole, the reason being that direct Commonwealth expenditures were greater there, in proportion to receipts, than in other states. New South Wales and South Australia, on the other hand, received more than the three-fourths every year. For the significant feature of the book-keeping system was that, while the states as a whole had to receive at least three-fourths of net customs and excise revenue, each individual state received from the Commonwealth just what it would have received if the same scale of customs and excise revenue and of expenditures had existed without federation. It is for this reason that the Commonwealth can be regarded, during these years, as essentially the agent of the states to collect revenue and make expenditures which but for federation would have been collected and expended by the states individually in much the same form and, with one exception, to much the same amount. There was, of course, one change which was of great importance in itself, namely, the establishment of uniform customs and excise duties, and correlative interstate free trade.

Section 93 was to operate for five years after the imposition of uniform customs duties and thereafter until Parliament otherwise provided. By section 94, "After five years from the imposition of uniform duties of customs, the Parliament may provide, on such basis as it deems fair, for the monthly payment to the several states of all surplus revenue of the Commonwealth." This gave Parliament power to use the Braddon Clause payment as an instrument of equitable adjustment as between states, but in fact this was not done, the book-keeping system being continued until termination of the Braddon Clause in 1910. Nor were any payments made under section 96.

The only discrimination between states in this period came through the operation of section 95. Even here, while one state was given special assistance, it rested upon taxation of its own citizens and did not exact a contribution from other states. As an inducement to Western Australia, the state least enthusiastic about federation, and also in recognition of the fact that, as the most pioneer state, it would suffer particular disabilities during the early years, it was provided by section 95 that, if Western Australia had agreed to join the federation by the date of the establishment of the Commonwealth and thus became an "original state", it should have the right for five years after imposition of uniform Commonwealth customs duties, itself to impose annually decreasing duties on goods originating in other states and passing into Western Australia. The duties were collected by the Commonwealth, and returned to the state in the same manner as other Commonwealth surplus revenue. During the years 1901-2 to 1906-7 the payments by the Commonwealth to Western Australia inclusive of these special customs duties, amounted to £6,230,000 as compared with only £1,378,000 received by the state from its own taxation. The gross revenue from the special tariff was £869,000.

Other financial provisions of the constitution, chiefly those relating to taxation and the assumption of state debts by the Commonwealth, are referred to in subsequent sections of this memorandum.

II. COMMONWEALTH AND STATE FINANCES FROM 1901 to 1910

The significant features of state finances prior to federation were the large public debt which had been incurred in the course of settlement and development, and consequently large annual interest charges; the management of state business undertakings, particularly railways, which represented a burden on budgets except in really prosperous periods; and the dependence

upon customs and excise revenue.

Total loan, or capitalized expenditure of the states up to June 30, 1901 was approximately £198 millions, and their public debts amounted to £204 millions at that time, or £53½ per head. At that time the average interest rate was only 3.7%. The capital cost of construction and equipment of government railways and tramways alone amounted to approximately £124 millions, virtually all of which had been raised by loan and is included in the foregoing totals of loan expenditure and public debt. The railways had losses, after meeting interest payments, during the first five years of federation, but by 1910 were operating at a combined net profit of about £1 million per annum. In subsequent years, however, the situation deteriorated.

With respect to ordinary government revenues, up to 1901 each state was free to impose taxation and otherwise raise revenue in any way it saw fit. All states acted along much the same lines, though of course rates and incidence of taxation varied widely. The most important tax revenue (at least 80% of the total) was that from customs and excise, the customs tariff applying to imports from other states as well as from the outside world. Direct taxation was relatively small in amount by comparison with indirect taxation, but included all the standard forms, that is, income tax, succession and probate duties, land tax, etc. The magnitude of the dislocation in state finances caused by federation and the necessary transfer of customs and excise revenue to the central government may be illustrated as follows. The revenues and expenditures of Commonwealth and states combined in 1901-2 may be taken as a rough indication of what the position of the states would have been but for federation. Omitting revenues and expenditures of railways and the post office, except so far as a net profit or loss accrued thereon, customs and excise revenue was nearly 3¼ times as great as other taxation, and amounted to

one-half of total revenue. Under federation, all this went to the Commonwealth, which, however, assumed only one-twelfth of total expenditures, as above defined. The Commonwealth surplus paid to the states in 1901-2 was 82% of all other state revenue and 2¾ times as great as their total tax revenue; it was 83% of total Commonwealth revenues, as defined. To all intents, the federation was just a customs and postal union.

The last year of Braddon Clause payments was 1909-10, by which time Commonwealth activities were showing signs of expansion, with new expenditures on sugar bounties (£408,000) and old-age pensions (£841,000 from revenue, but £1,500,000 in all) and an increase of £600,000 in defence expenditures. As regards the states, however, the situation had changed little. Although the Commonwealth had no surplus to disburse other than that required by the Braddon Clause, the increase in the customs tariff in 1907 had considerably augmented the Braddon Clause payment itself. In 1909-10 the Commonwealth payment was about 67% of all other state revenue and 2¼ times as great as tax revenue. A more significant comparison is that the Commonwealth payment amounted to 42% of state expenditures, as defined, in 1901-2, and 44% in 1909-10. Over the whole period from January 1, 1901 to June 30, 1910, the payments to the states amounted to 82% of net customs and excise revenue, and 79% of gross Commonwealth revenue other than post office receipts.

Considerable attention has here been paid to the 1901-1910 period because of its underlying importance in all subsequent developments in Australian inter-governmental financial relations. The original provisions of the constitution, together with the new arrangement of 1910 discussed below, determined the financial inferiority of the states and their essential dependence upon the Commonwealth, so that some such arrangement as that of 1927 appears, in retrospect, to have been inevitable, lacking a complete revision of the constitutional allocation of legislative powers and responsibilities.

III. ALTERATIONS OF THE FINANCIAL RELATIONSHIP, TO 1910

The compromise with the free-traders over the Braddon Clause had deprived the states of the permanent constitutional guarantee of three-quarters of net customs and excise revenue, as originally proposed. In addition, the book-keeping system presented obvious difficulties. During the first ten years, numerous proposals for a new arrangement were discussed at general conferences of state Ministers. There were eleven such conferences during the period, several of which were attended by representatives of the Commonwealth. The proposals were variously to increase Commonwealth governmental responsibilities, or to substitute for the Braddon Clause and the book-keeping system the payment of a fixed annual sum, or a fixed annual sum per capita, or distribution of Commonwealth surplus on a per capita basis. No agreement was reached until the course of events and the approaching end of the 10-year period of guarantee made action imperative.

The Commonwealth had from the first adopted a practice of setting up trust accounts for certain expenditures, and as a result appropriations from consolidated revenue in any year might be greater or less than actual expenditures inclusive of disbursements from trust funds. The effect was apparently not important until 1907-8 when the invalid and old-age pensions scheme was established. Payments of pensions were not to commence until 1909, but a trust fund was set up, into which the Commonwealth commenced to pay its surplus revenue, except that required to be turned over to the states under the Braddon Clause, as a reserve for future pension payments. The Surplus Revenue Act of 1908 terminated the operation of section 93 of the constitution (as the Commonwealth was entitled to do five years after the imposition of uniform customs duties) and in pursuance of section 94 the Act, although it continued the book-keeping system with respect to the Braddon Clause, provided that any

further surplus should be distributed on a new plan, essentially based on proportionate population. This last, which was continued in the Surplus Revenue Act of 1910, is only of theoretical interest, since "care has been taken that there shall be no surplus revenue in the legal sense" by means of the trust fund device.

The Commonwealth Grants Commission remarks (1st Report, p. 20) that "The provisions of sections 87, 89, 93 and 94 were undoubtedly believed by the states to secure that the surplus Commonwealth revenue should be paid over to the states". This was carried out until the change in 1907-08. The legality of treating payments into trust funds as current expenditures in arriving at the surplus to be paid to the states, was challenged by New South Wales, but upheld by the High Court. This effective termination of the surplus revenue provisions of the constitution, says the Grants Commission, "was a departure from what was believed to be the intention of the constitution. It gave rise to criticism and has led to discontent". The states were left with no legal safeguard other than the Braddon Clause, which could be terminated in 1910, and they had had an early indication that the central government was not inclined to pay more than it was legally forced to pay. With the demise of the Braddon Clause, future payments would require negotiation and would depend on obtaining an agreement with the Commonwealth.

As previously pointed out, the states in 1909 were very little better able to stand on their own feet than in 1901. The Commonwealth, on the other hand required increasingly greater funds and was not able to continue direct assistance on the previous scale, unless it should go into the field of direct taxation, which was not envisaged at that time and would certainly have been contrary to current notions of its proper sphere of taxation. The Commonwealth programme now included the White Australia policy, and in pursuance thereof the establishment of an Australian Navy and compulsory military training which required

large expenditures. Invalid and old age pensions also required increased funds, although such expenditure by the Commonwealth directly lessened the assistance required by the states, of which three had previously instituted such pensions themselves, and the others no doubt would ultimately have been forced to do so if the Commonwealth had not. Finally, public opinion at the time favoured large Commonwealth resources in the face of threatening international developments.

At a conference of Premiers in March 1909 provisional agreement was reached on a plan which amounted to re-affirmation of the Braddon Clause in permanent form, but with payments on the basis of three-fifths of gross customs and excise revenues, with a special concession to Western Australia. In August, however, this was changed, when the Commonwealth Prime Minister and state Premiers agreed on an entirely new plan, which was to be put into effect by amendment of the constitution. The agreement recited that, "in the public interests of the people of Australia, to secure economy and efficiency in the raising and spending of their revenues, and to permit their Governments to exercise unfettered control of their receipts and expenditure, it is imperative that the financial relations of the federal and state governments -- which under the constitution were determined only in part, and for a term of years -- should be placed upon a sound and permanent basis".

Clause 1 dealt with a matter upon which no positive action was taken until eighteen years later: in order "to fulfil the intention of the constitution by providing for the consolidation and transfer of state debts and in order to insure the most profitable management of future loans by the establishment of one Australian stock", a complete investigation of the matters involved was recommended to be made forthwith.

Clause 2 set forth the new system of payments by Commonwealth to states, namely twenty-five shillings per capita, commencing in 1910-11, the objects of the change being "to give

freedom to the Commonwealth in levying duties of customs and excise, and to assure to the states a certain annual income". By Clause 4 a special grant was to be made to Western Australia in view of its "large contribution to the customs revenue per capita". Clause 3 provided that the Commonwealth's probable deficit in 1909-10 should be met by deductions from the payments of that year amounting to three shillings per capita for the three states which were being relieved of the expense of their own old-age pension schemes, and two shillings for the other states.

Constitutional amendments were duly prepared and submitted to the electors. One, amending section 105 so that the amount of state debts that might be taken over by the Commonwealth should not be limited to those existing at the time of federation, was approved. The other, embodying the new financial arrangement, was rejected, strong popular opposition having developed to what was described as "leg-roping" the Commonwealth by embodying the new plan as part of the constitution.

The result of the referendum left the states dependent on voluntary action by the Commonwealth Parliament. The latter proceeded to put the new plan into effect by statute; the Surplus Revenue Act of 1910 declared the new scale of payments should continue for ten years certain, "and thereafter until the Parliament otherwise provides", which was, in the event, in 1927. The Act expressly terminated the operation of section 87 (the Braddon Clause) at the earliest possible date, December 31, 1910, and provided that thereafter payments should be on the basis of twenty-five shillings per head of population in each state, subject to a deduction of £450,000 in 1910-11 to meet the Commonwealth's net deficit from the previous year.

The chief features of the new system were, first, that the amount to be received by the states was less than they had been receiving under the Braddon Clause. Both before and

after the conference of 1909 the representatives of the states sought to obtain a larger fixed payment, and also an additional payment varying with customs receipts. The amount decided on, however, was the most the Commonwealth government would agree to recommend to parliament, which had to initiate the proposed constitutional amendment, and after the rejection of the amendment the Commonwealth naturally would not increase the sum. Secondly, the subsidy established in 1910, like that which preceded it, represents essentially an adjustment between the central government and the states as a whole, remission rather than re-distribution. In later years the method of payment on a per capita basis, out of moneys collected (with the advent of the federal income tax) in part according to capacity to pay, was lauded by some economists (including Professor Giblin) as a measure of re-distribution between states, and of compensation for the differential effects of tariff protection; but such was not the intention at the time. In 1909-10 the states contributed to federal revenues closely in the same proportion as their respective populations, except for Tasmania and Western Australia. The former was contributing just over 80% of its quota on a population basis, but the latter's figure was 133% or an excess of 33%. This excess contribution by Western Australia was recognized in the provision of an additional annual payment to Western Australia of £250,000 in 1910-11, decreasing £10,000 each year, such payments to continue for ten years and thereafter until parliament otherwise provided. Thirdly, by the will of the people of Australia, the states were now left without any constitutional claim on Commonwealth revenues, but with their own budgets as dependent as before on a large share of such revenues. The proposed constitutional amendment would have given the states a permanent charge on the whole revenues of the

Commonwealth. With the rejection of that amendment, the payment they received became an outright subsidy, subject to withdrawal by the Commonwealth should it see fit to do so. It was the weapon so acquired that was used in 1927 to secure acceptance of the proposals embodied in the Financial Agreement.

IV. CONDITIONS OF STATE FINANCES 1910-1927

It was not long after the passage of the Surplus Revenue Act of 1910 that state finances entered an unsatisfactory condition which, save for temporary and occasional improvement, continued throughout this period. The danger of such a condition developing had been latent in the constitution from the beginning, particularly in view of the limitation of the Braddon Clause to ten years. The principle had been firmly established that state budgets were to be balanced only with the assistance of substantial payments from the Commonwealth, although the implications of this were not fully realized at first. For one thing, the Grants Commission (1st Report, p.20) concludes that probably "the parties contemplated the revenue difficulties of the states as incident only to the earlier years of federation, and perhaps rather optimistically envisaged a period in the future when no adjustment might be required". Secondly, aside from the specific amount required to be paid for ten years by section 87, the provisions of the surplus revenue sections (90, 93 and 94) "were undoubtedly believed by the states to secure that the surplus Commonwealth revenue should be paid over to the states". Cancellation of section 93 by the Act of 1908, and effectual cancellation of section 94 through the device of trust funds, roused bitter criticism by state governments as a departure from what was claimed to be the intention of the constitution. The Grants Commission remarks that while it is arguable that section 94 is an enabling power only, yet "the Commonwealth has never actually disputed the right of the states to any surplus revenue where it can be shown

to exist", but "care has been taken that there shall be no surplus revenue in the legal sense". In the result, as stated, the states were, from 1910 to 1927, subject to the will of the Commonwealth in the matter of subsidies.

At any rate, during this period state finances were for a large part in an unsatisfactory position. Loan expenditures continued with virtually no repayments of past borrowings, while the revenue situation changed from one of surpluses to one of deficits. The Grants Commission has calculated that in the period 1901-10 the states as a group had a revenue surplus of £5,155,000, or an annual average of £573,000, whereas in 1910-27 they had deficits of £15,475,000, or an annual average of £910,000. The states' own revenues in this period, that is exclusive of the per capita payments under the Surplus Revenue Act of 1910 and various special grants from the Commonwealth to individual states, were exceeded by their current expenditures by approximately £130 millions, or an annual average of £7,643,000. In other words, federal subsidies of the types mentioned came to a total of £114.5 millions over the seventeen-year period.

With the great increase in Commonwealth customs revenues, the per capita payments represented much less than what would have been paid if the Braddon clause had not been terminated by the Commonwealth in 1910. The "deficiency" of the per capita payments alone on this basis for the seventeen years 1910-27 amounts to £183,000,000, although this was offset to a small extent by various special grants and other forms of additional assistance. It is clear that the actual change in economic conditions would have resulted in payments to the states, under an extension of the Braddon Clause, far in excess of their needs, and far in excess of what the Commonwealth could have paid in view of its heavy expenditures arising from the War.

Another way of looking at the matter is noted by

the Grants Commission Report when it points out that: "An important factor in benefitting Commonwealth finance at the expense of the states was the fall in the value of money between 1909 and 1920....By 1920 the value of the £1 was nearly halved, and remained near that level for the next decade". No one in 1909 foresaw the rise in prices, and no suggestion was made to vary the per capita payments according to the value of money. The Commission says that if this had been done, the states would "by now" (apparently this would be 1936, the date of the third Report) have received £100,000,000 more than the payments actually made. On such a basis, the Report states, "The financial position of the states as a whole would have been very much on a level with that of the Commonwealth", but in fact no such arrangement could have continued, owing to the strain on Commonwealth finance. "One may conclude that the original per capita arrangement would have worked very fairly between the Commonwealth and states had it not been for the abnormal disturbance of the War."

Still another factor in the financial difficulties of the states is found by the Commission to reside in their "policy of very heavy borrowing for developmental projects, which were beginning to fail almost as soon as they were begun". Elsewhere in the Report it is said that such projects were in large part justified, both by the conditions of the time, including the general optimism regarding the future, and by the universal view in Australia that it was the duty of the states to open up, settle, and develop their territories. In certain notable instances, however, the undertakings either could not be initially justified or were very badly managed. However that may be, heavy losses were incurred on the services on which this loan money was spent, and the Commission finds that such losses "are more than sufficient to account for all the state deficits". Such a statement is perhaps more applicable to the depression years after 1927 than to the entire period 1910-27.

The influence of the War, as already stated, was very great. The great rise in prices, attributable to the War either directly or indirectly, greatly increased state expenditures, and particularly those on loan works, without increasing state revenues in the same proportion. The states were not slow to point out that the Commonwealth collected large sums in customs duties on goods imported by state governments in connection with their loan works, such as railroad equipment. More important, however, was the necessity for the Commonwealth Government to resort to direct taxation on a large scale. No direct taxes (other than a land tax imposed for non-fiscal reasons) were levied by the Commonwealth until 1915, at which time the introduction of a federal income tax was attacked in some quarters as a violation of the intention, at the time of federation, that the central government should finance itself entirely from indirect taxation. No legal justification for such an argument can be found in the constitution, and customs revenue was clearly inadequate to meet the urgent requirements of war expenditures. Thenceforth the states were severely limited as to the extent to which they could augment their own revenues from taxation, even by raising tax rates, which they did almost to the point where further increases would result in diminished returns.

Total state deficits during the period 1910-27 amounted to £22,759,000 and total surpluses to £7,283,000, leaving a net deficit for the period of £15,476,000. There were only two years in which the states as a group had a net surplus. Among the individual states, the position was as follows:

States' Surpluses and Deficits 1910-27

State	Years of Surplus	Years of deficit	Accumulated net deficit 1910-27: Total £000	Per head of population at June 30, 1927 £
New South Wales	8	9	4,236	1.76
Victoria	11	6	701	0.40
Queensland	10	7	1,956	2.24
South Australia	9	8	1,909	3.38
Western Australia	2	15	6,167	15.73
Tasmania	8	9	507	2.40
All States	2	15	15,476	2.51

(In making comparisons between states, the assistance received by Western Australia and Tasmania by way of special grants must be taken into account - see section 6, infra. Western Australia's deficits were also affected by the lesser severity of taxation in that state.)

There were two intervals of comparative buoyancy, namely from 1910-11 to 1913-14 when, although the states experienced a sudden change from surpluses to deficits consequent upon the altered scale of subsidies, net deficits over the period averaged only £266,000 per annum; and 1922-23 and 1923-4 when for the States as a group budgets were almost in balance. During the War and immediate post-war period deficits were very large, and after 1924 a renewed period of growing deficits became apparent, particularly when the large increases in special grants are taken into consideration.

It has been mentioned previously that a striking difference between Australia and Canada is the fact that in Australia railways are very largely a state rather than a federal matter. (There are no private railways). State railways have in the past decade incurred very heavy deficits, which have in some years turned what would otherwise be government surpluses, on ordinary account, into deficits, as shown below:

State Railway Deficits 1925-6 to 1934-5

£ 000

	Railway operating surpluses	Interest on railway loan expenditure	Deficit after meeting interest	Total state deficits
[1]925-26	6,545	13,231	6,686	2,154
[1]926-27	8,575	14,060	5,485	217
[1]927-28	9,765	14,510	4,745	1,084
[1]928-29	11,089	15,100	4,011	3,046
[1]929-30	7,933	15,517	7,584	8,878
[1]930-31	7,407	16,205	8,798	15,528
[1]931-32	9,516	14,329	4,813	20,803
[1]932-33	10,571	13,673	3,103	7,955
[1]933-34	10,426	13,165	2,740	6,994
[1]934-35	11,680	12,746	1,066	3,265

(Note: Exchange on interest payments abroad is not included in the railway figures. The reduction in interest payments in 1931-32 and subsequent years reflects the results of the debt conversions and also the elimination of the interest charge on the capital sum of £28,000,000 in respect of Queensland, which assumed that sum as part of the general debt of the state on the ground that it was not equitable to burden the railways with interest charges on such part of their capital cost as was incurred for the purpose of developing the state rather than as a business venture.)

This long period did not pass without repeated efforts on both sides to arrive at a more satisfactory settlement, if possible on a permanent basis. These are summarized in a subsequent section dealing with the Financial Agreement of 1927. Other aspects of federal-state financial relations, which are of importance as forming the background of that Agreement, are discussed in the ensuing section.

V. CHIEF FEATURES OF FEDERAL AND STATE FINANCES 1901-1928

This section is intended to cover what appear to be the significant features of Federal and state finances from federation up to the time of the constitutional amendment of 1928, with the exception of federal subsidies to states, both general (see sections 1-4) and special (section 6). The matters dealt with fall into three main categories, namely, public debt, taxation, and conflict and co-operation between Commonwealth and states.

(1) Public debt

No part of the debt of the states was transferred to the Commonwealth by the constitution, and it was not until the war that the central government incurred debts of any size. The constitution did, however, make provision for subsequent transfer of state debt to the Commonwealth (section 105), not by way of relieving the states of ultimate liability, but as a means of consolidation and simplification of the debt structure. Sec. 105 empowered the Commonwealth to take over all or part of the debts of the states as existing at the time of federation. All interest payable on such debts was to be deducted from the payments of surplus Commonwealth revenue to the states, with the deficiency, if any, to be paid by the states to the Commonwealth. A constitutional amendment, approved by referendum in 1910, enlarged the scope of this provision by striking out the limitation "as existing at the establishment of the Commonwealth".

An early Commonwealth Year Book remarks that, "the prospective savings in the matter of interest to be effected by means of the consolidation of the state debts formed a strong argument in pre-federal days for those supporting the federal movement. Since the establishment of the Commonwealth, however, the individual states do not appear to have become willing to accept a Commonwealth control of state indebtedness." The

matter was discussed at numerous conferences prior to 1910, but all attempts to arrive at a satisfactory formula, as part of the readjustment necessary upon the expiry of the Braddon Clause, were unsuccessful. The Agreement of 1909 re-emphasized the importance of the matter, but nothing was done. Although again under discussion on several occasions subsequent to 1910, no action was taken under section 105 until 1927, and then it was conditional upon the passing of a constitutional amendment.

There were, however, two relatively small transfers of indebtedness during this period of a different character, being essentially purchases of state property by the Commonwealth. The first occurred in 1911 when the Commonwealth took over from South Australia the administration of the Northern Territory and ownership of its land and resources, and of the Port Augusta-Oodnadatta Railway. The debt of South Australia incurred in respect of the Territory and the Railway was thereupon assumed by the Commonwealth, the total amount being approximately £6,000,000.

The second was a consequence of the transfer of various state departments to the Commonwealth at the time of federation which included the handing over of various properties, such as post offices, customs houses and defence works. So long as all Commonwealth surplus revenue was returned to the states, the question of compensation for these properties did not become acute, but after the establishment of the new system of subsidies, the states pressed for settlement. In 1911 the Commonwealth began to make additional payments to the states designated as "interest on transferred properties", and amounting to 3½% per annum on the estimated value, which was originally £9,648,000 and was £11,000,000 in 1927. Such valuation appeared after 1911 as part of the public debt of the Commonwealth, causing a duplication in Commonwealth and state figures since the original expenditure created an equivalent item in the state's public debt. It was not until 1929 that an equivalent amount of

the states' bonds was definitely taken over by the Commonwealth.

During the period 1901-1928, the public debt (including short-term debt) of the Commonwealth and states, after adjusting for duplications and for certain remissions of state indebtedness to the Commonwealth, increased as follows:

Amount outstanding June 30th

£000

	Commonwealth	States	Together
1900	nil	197,035	197,035
1910	nil	258,532	258,532
1920	352,439	425,903	778,342
1928	380,382	714,421	1,094,803
1928 per capita	£ 60.36	£ 113.59	£ 173.72
1900 per capita	nil	52.68	52.68

Of the loan expenditure constituting the Commonwealth debt, almost 80% was on account of the War, and post-war repatriation services, the balance being for public works. The Commonwealth had no public borrowings until the War, and its debt only increased by 8% from 1920 to 1928.

The increase in the states' debt is striking. Their average loan expenditure per annum in 1901-10 was £6,000,000; in 1910-20 it was £17,000,000; in 1920-24: £34,000,000; and in 1924-28: £38,000,000(all figures are approximations). During the earlier period (1901-10) the chief items were railway construction and water supply. For the period 1910-20, the same two items constituted over half the total expenditure, with loans to settlers and purchases of land for settlement beginning to be important. In 1920-24 large expenditures were made in connection with settlement of returned soldiers on the land, and total expenditures on land settlement of various kinds were greater than railway expenditures. In the period 1924-28, railways, water supply, harbours, roads and bridges were the chief items.

Rough approximations of state loan expenditures over the entire period would be as follows:

£ 000

	Approx. Total to 1901	Approx. 1901-1928	Total to 1928
Railways and tramways	124,000	202,700	326,700
Water supply, water conservation, and sewerage	26,800	78,600	105,400
Advances to settlers and purchase of land for settlement	2,000	83,000	85,000
Harbours, rivers, roads and bridges	20,800	48,500	69,300
All other, including public buildings, electricity undertakings, revenue deficits funded, etc.	24,600	93,700	118,300
Total	198,200	506,500	704,700

A considerable portion of Australian public debt was incurred overseas. In the period before federation, London was virtually the only source of capital for Australia, and in 1901 the sterling debt amounted to 86% of total state public debt. The trend had already changed, however, and by 1912 the proportion was 70%. In 1928, 40% of Commonwealth debt and 58% of state debt was payable overseas, chiefly in London, though a few loans had been floated in New York. Total public debt payable overseas, amounting to £570,000,000, was 52% of combined Commonwealth and state public debt in 1928.

The rate of interest payable has varied considerably. In 1901 state debt was subject to an average rate of 3.68%. By 1925 the average for all state debt outstanding was 4.85% and there was little change until the conversion in 1931-2. For Commonwealth debt the average in 1918 was 4.4%, and in 1928, 5.2%. As between overseas and internal debt, average rates at June 30, 1928 were as follows:

	Overseas %	Internal %	Total %
Commonwealth	5.00	5.32	5.20
States	4.70	5.20	4.91
Together	4.79	5.25	5.01

Comparisions of public debt figures are always rendered difficult by the differences between countries, states and provinces with respect to the particular activities of various authorities. Thus in Australia some 45% of total state debt outstanding in 1928 had been incurred for capital expenditure on government railways. As between states, the proportion varies from under 30% to 55%. Other loan expenditures are also represented, in various degrees, by capital assets, some directly productive of income either for the governments or the inhabitants of the states. A further complication arises from differences in the division of functions between state governments and municipalities. Complete records of municipal finance for earlier years are not available, but the Commonwealth Year Book contains a summary statement of municipal and semi-governmental debt in 1933-34 which, when added to state debt, enables a somewhat better comparison to be made between states, as follows:

	£ 000(c)				
	State Debt(a)	Other Debt(b)		Grand Total	Per Capita
		Municipal	Semi-governmental bodies	£ 000	£
N. S. W.	324,607	34,061	11,514	370,182	141.2
Victoria	172,972	11,976	37,268	222,216	121.4
Queensland	117,817	15,183	928	133,928	139.8
South A.	104,614	769	1,399	106,782	183.1
Western A.	85,848	3,164	92	89,104	201.6
Tasmania	23,650	2,735	74	26,459	116.0
Total States	829,508	67,888	51,275	948,671	142.4
Commonwealth debt for Commonwealth purposes				393,051	58.9
Public debt of Australia, June 30, 1934				1,341,722	201.3

(a) Including amounts owed to state governments by "municipal and semi-governmental bodies".

(b) Debts of municipal and semi-governmental bodies other than their indebtedness to state governments.

(c) Face value, irrespective of foreign exchange variations.

(2) Commonwealth Loans to States

An outstanding illustration of the close connection between Commonwealth and state finances from early times is afforded by the extent to which loans were made by the central to the local governments. In effect, the credit of the whole country was utilized for the benefit of the constituent parts, a development which, beginning long before the inauguration of the Loan Council, took many different forms.

The first of such loans was made soon after the passing of the Australian Notes Act of 1910. By that Act the Commonwealth Treasurer was authorized to issue notes (directly analogous to the former Dominion Notes in Canada) which should be legal tender throughout Australia and redeemable at the seat of the federal government. As only a 25% gold reserve was required to be kept, there was considerable latitude in the amount of notes that might be issued, although in fact emissions were only made against either gold or investments. Under the latter category came what were really loans from the Australian Notes Account (which was kept in the Commonwealth Trust Fund) to both the Commonwealth and state governments, new government securities being sold directly to the Account.

As at December 27, 1912 the amount of such loans outstanding to state governments, and represented chiefly by short-term securities including Treasury Bills, was £6,948,000.

In the year 1913-14 the Commonwealth began to call in such advances so far as possible, but on the outbreak of the War the trend was once more reversed. It seemed probable that loans for other than military purposes would be difficult to obtain in London. But cessation of loans would have seriously embarrassed several of the states which were committed to a vigorous public works and developmental policy. The Commonwealth Government met the situation by agreeing to lend the states (except Queensland, which did not enter the arrangement) a total of £18,000,000. The money was taken entirely from the Australian Notes Account (against

debentures and treasury bills of the states), was paid in monthly instalments, and bore interest at 4 1/8%. Repayment was to be made within five years of termination of the War, but not later than 1925. The total amount so loaned was about £22,000,000.

The next development, also as a means of assisting the states' public works programs, consisted of loans to the states of money raised by public loans on the credit of the Commonwealth. This was authorized by two Acts of 1916, and during 1916-19 the sum of £16,750,000 was lent to the states out of the proceeds of Commonwealth loans contracted in London, carrying interest at 5¼% and 5½%.

The above amounts represented unconditional loans. In addition, subsequent to the war, other sums were loaned to the states for specific purposes, including soldiers settlement, construction of facilities for wheat storage, immigration, the provision of reserve employment for returned soldiers, etc. Between 1919 and 1924 such loans, chiefly for purposes of soldiers settlement and made out of the Commonwealth War Loan Fund, came to a total of approximately £38,500,000.

Again, after 1924, the Commonwealth adopted the practice of 1916-18, namely raising loans specifically on behalf of the states, the total amount being approximately £69,000,000 in the four years 1924-28. The proceeds were used chiefly for public works. Conversion operations are not included. Some of these loans were raised under the auspices of the first, informal Loan Council, discussed below.

Taking these various items together, between 1911 and 1928 the states were enabled to obtain loans to the amount of about £145,000,000 in addition to their borrowings from the general public.

(3) <u>The first Loan Council</u>

As early as 1914 a Conference of Treasurers considered proposals to prevent competition for loans among the states, but

no formal method of co-operation was achieved. Inter-governmental conferences have been the rule rather than the exception in Australia, notably the Premiers' Conferences, held almost every year since the establishment of the Commonwealth, and it was to be expected that some further progress with regard to loan flotation would eventually be made. It was in 1923 that a specific body was first set up, consisting of the Treasurers of the Commonwealth and of the states, and owing its creation to representations made by the Commonwealth. The already existing practice of the Commonwealth in using its credit to assist the raising of money for the states was thus greatly facilitated, although the original object in establishing the Australian Loan Council was to prevent undue competition and clashing in the raising of loans so far as these were raised by the separate governments.

At its first meeting, in February 1924, the Council concentrated upon securing co-operation among the several governments with regard to their several loan flotations. The terms of all loans to be made during the balance of the year 1923-24 were agreed to, and timing was so arranged as not to interfere with the Commonwealth's flotation of its War Gratuity Redemption and Conversion Loan.

At meetings in June and July 1924 the Council further developed plans for control and limitation of borrowing, including the idea of having some central body functioning on behalf of both states and Commonwealth. All governments accepted the Council's recommendations for reductions in contemplated loan programmes, and the Council itself decided the proportion of overseas to internal borrowing in 1924-25. All borrowings in that year were carried out in accordance with the Council's plans. For the following year, it was agreed that no internal borrowings should be undertaken until the successful conversion of £67,000,000 of Commonwealth War Loan maturing in December 1925. This was carried out, but the voluntary Council virtually

came to an end when New South Wales withdrew late in 1925 in order to re-assume freedom of action in raising loans greater than the Council would approve. The experience gained and the precedents established under this voluntary scheme, however, were of the greatest value in supplying an additional incentive for consummation of the Financial Agreement of 1927 and in the successful working of the new Loan Council thereby established by law with compulsory powers.

(4) Taxation

At the time of federation most of the states had in force virtually every form of taxation, including income taxes. By the constitution they were restricted to direct taxes, while the Commonwealth was given unlimited power of taxation, although at the time it may well have been taken for granted that indirect taxes would more than suffice for Commonwealth purposes, as indeed would have been very largely the case but for the War.

Customs and excise duties constituted over three-fourths of state tax revenues prior to federation, and transference of these to the Commonwealth resulted in a large surplus for it, and a deficit for the states. It is not surprising, therefore, to find the following in the Commonwealth Year Book for 1908: "The question of the imposition by the Commonwealth Parliament of direct taxes such as land and income taxes is one which has been the subject of considerable discussion, and the opinion has been expressed that the intention of the framers of the constitution was that of restricting the taxation powers of the Commonwealth to the imposition of customs and excise duties except in cases of great national peril." Certainly there is no such limitation in the language of the constitution, and in any case the War supplied full justification from every point of view for the imposition of direct taxes by the Commonwealth.

Taxation in Australia at various dates may be seen from the following, which shows total tax collections, whether receipts

formed part of Consolidated Revenue Funds or were paid into special funds, but excluding lottery taxes.

Tax Collections

Fiscal Year	Commonwealth £000	States £000	Together £000	Together per capita
1901-02	8,894	2,812	11,706	£ 3.06
1909-10	11,593	4,113	15,706	3.63
1914-15	16,870	6,996	23,866	4.80
1919-20	41,102	14,299	55,401	10.45
1924-25	52,836	22,634	75,470	12.84
1927-28	56,638	31,813	88,451	14.16
1930-31	50,420	35,476	85,896	13.23
1934-35	58,755	36,019	94,774	14.15
1936-37	62,846	45,457	108,303	15.92

Direct and Indirect Taxes
£000

	Indirect	Total Direct	Direct	
			Commonwealth	States
1901-02	8,894	2,812	nil	2,812
1909-10	11,593	4,113	nil	4,113
1914-15	14,877	8,989	1,993	6,996
1919-20	21,575	33,826	19,527	14,299
1924-25	37,193	38,277	15,643	22,634
1927-28	41,447	47,004	15,191	31,813
1930-31	31,768	54,128	18,652	35,476
1934-35	47,222	47,552	11,533	36,019
1936-37	50,989	57,314	11,857	45,457

The change in the situation as between states may be seen from the following figures of per capita taxation:

	1901-2	1927-8	1934-5
	£	£	£
New South Wales	0.82	5.44	5.30
Victoria	0.70	4.14	4.90
Queensland	0.57	6.10	6.74
South Australia	0.75	6.57	5.60
Western Australia	0.89	3.97	5.50
Tasmania	0.64	3.20	3.83
All States	0.74	5.10	5.38
Commonwealth	2.33	9.06	8.77
Australian Total	3.07	14.16	14.15

By 1910 all states were levying probate and succession duties, stamp duties, land tax, and income tax, and as well were deriving substantial revenues from sales and rentals of crown lands, licences, etc. The only avenue of increased revenue was raising the rates of taxation. Commonwealth taxation, consisting

solely of customs and excise duties up to 1910, broadened during 1910-20, chiefly as a result of the War, to cover the whole field of direct taxation. The first land tax was enacted in 1910, with the special object of breaking up large estates. An estate duties tax was levied in 1914; income tax in 1915; entertainments tax in 1916; and a "War Time Profits" tax in 1917, the latter affecting only profits arising prior to June 30, 1919.

Commonwealth direct taxes reached their peak in the period 1919-22, exceeding state taxation by 25%, but thereafter Commonwealth revenues from this source declined somewhat as a result of reductions in rates while state tax revenue doubled between 1920 and 1927.

The Commonwealth's duplication of all their taxes naturally lowered the maximum revenue available to the states, and the increase which they achieved up to 1927 seems to have nearly exhausted their revenue possibilities. (Relative severity of taxation as between states is discussed in connection with the Commonwealth Grants Commission.) But tax duplication became a matter of controversy in federal-state relations long before this point was reached and was discussed at numerous conferences. The quantity of Commonwealth revenues from direct taxes had an obvious connection with the need of the states for increased federal subsidies, and on the administrative side the lack of uniformity in tax laws, particularly as between the states as a group and the Commonwealth, and the overlapping of collection agencies, were also a source of dissatisfaction. Proposals for re-division of fields of taxation were made at numerous Premiers' Conferences from 1919 on, in connection with adjustment of the subsidy system. Attention was chiefly centred on the income tax, whose importance may be judged from the following:

	1919-20	1927-28
Commonwealth		
	£000	
Total direct taxation	19,527	15,191
Income tax only	12,848	10,165
States		
Total taxation	14,299	31,813
Income tax only	6,605	15,527

However, lacking any constitutional change in legislative functions, it would have been impossible for the Commonwealth to have given up even the income tax, which alone brought in more revenue than the cost of the per capita subsidies. Such an adjustment would also have failed to deal with the growing problem of the special needs of several states which were receiving special grants, and in fact would have aggravated their difficulties, since in those states, federal income tax collections were less than the per capita subsidies.

The states, on the other hand, were unwilling to give up any of their existing sources of revenue, so that no action resulted from the opinion expressed by the Royal Commission (1920) on taxation that the power to impose an income tax should be exclusively vested in the Commonwealth, and that all other forms of direct taxation should belong solely to the states, subject only to overriding powers of the Commonwealth in time of war (Second Report, 1922).

With respect to administration, however, some progress was made. In 1921 an agreement between Western Australia and the Commonwealth went into effect whereby the two tax departments were consolidated under the control of the Commonwealth, which undertakes the collection of all state taxes and receives compensation from the state for the work. With regard to the other states, after seven years of negotiation agreement was reached on only one specific form of taxation, the income tax. By the 1923 agreements, both Commonwealth and state income taxes (in all states except Western Australia) are collected by state officers; the administration of the income tax is in accordance with the Commonwealth Income Tax Assessment Act, and a single

return is used except for income derived from more than one state. The cost of administration is of course partly paid by the Commonwealth.

(5) Co-operation between Commonwealth and States in governmental activities.

There have been several instances of co-operation between governments, chiefly in the form of joint Commonwealth and state expenditures on undertakings which the states were not able, and the Commonwealth unwilling, to undertake alone.

The largest of such undertakings, already mentioned in connection with Commonwealth loans to states, was that of settlement of returned soldiers on the land. In 1917 at the Premiers' Conference in Melbourne it was agreed that the states should undertake such work, and that the Commonwealth should obtain and loan to them the necessary funds. At a similar conference in 1919 the amount to be provided was fixed at £35,000,000, and in 1920 the maximum amount in respect of each settler was agreed at £1,000. These sums covered both advances to settlers as working capital and expenditures by the states for land purchases and public works incidental to settlement.

The original arrangement between the governments provided that the loans should be made to settlers by the states at reasonable rates of interest not exceeding 3½% in the first year, increasing by ½% in each subsequent year to the full rate of interest at which the money had been raised, plus working expenses, the difference between these rates and the rate paid by the government to be borne equally by the Commonwealth Government and the state government concerned.

The project was thus intended as essentially a self-supporting loan scheme, subject to the one qualification that interest losses in the early years would be paid by governments, and such net losses were to be shared equally between the central and local authorities. Two changes were subsequently made, each increasing the Commonwealth contribution. The first was that

the Commonwealth granted a rebate of interest (to the states) equal to 2½% per annum during a period of five years from the date of payment to the state of each instalment of loan money. Such rebates of interest amounted to approximately £4,750,000.

Remissions of capital to the amount of £7,600,000 were also subsequently made by the Commonwealth. The Report of Mr. Justice Pike on which such action was based had found that gross losses up to 1929, including losses on interest, on excessive management costs, and through failure of repayments by settlers, amounted to £23,500,000. The Report stated that in all negotiations between the Governments concerning soldier settlement the states had insisted on undivided control and should therefore bear full financial responsibility except as otherwise agreed. However, as a practical compromise, and in line with the original principle of equal sharing of interest losses, the Report recommended and the Commonwealth agreed that the total loss should be shared equally. The Commonwealth had already, in fact, gone part of the way by a remission of £5,000,000 in 1925.

Of the loans made, £27,000,000 were still unpaid by the states at June 30, 1935.

Other examples of loans by the Commonwealth to the states for expenditure on public works have already been mentioned. (subsection (2) supra) In such cases, there appears to have been no control by the Commonwealth over the expenditures. The case was different, however, with the so-called "grants to the states" for roads. These commenced with the Main Roads Development Act of 1922, under which and subsequent acts a total of £1,750,000 was provided by the Commonwealth from 1922 to 1926 for the purpose of reconditioning certain main roads. The states were required to find an additional £1,500,000, and all expenditures had to be approved by the Commonwealth Government. The plan was greatly extended by the Federal Aid Roads Act of 1926, under the authority of which the Commonwealth entered into an agreement with each state, which agreements taken together

required an annual expenditure of £2,000,000 by the Commonwealth and £1,500,000 by the states. The plan introduced a considerable measure of federal control over state activities by requiring that a portion of the states' contribution should be met out of revenue, by the limitation of expenditure of the grant to construction and requiring the states to be solely responsible for maintenance, and by the provision that all road projects must be approved by the Commonwealth Minister. One result was that roads so built paralleled the state railways, "bleeders instead of feeders" as they were called, and it was claimed by the states that this contributed largely to the great drop in railway revenues, especially after the onset of the depression. Criticism was also made on the ground that state expenditures were unnecessarily increased since a state government could not resist pressure from its people to take advantage of the federal offer.

The federal contribution was largely financed from customs and excise duties on petrol. In 1931 the plan was altered by limiting federal payments to revenue so received. The difficulties of the states were also alleviated by two substantial alterations in the whole scheme: the requirement of state contribution was dropped, and the federal contribution was permitted to be spent on maintenance.

In Australia, it would appear that the federal authorities have never admitted or assumed direct responsibility for either roads or railways. The manner and extent of federal assistance in connection with roads indicates special action partaking of the general character of piece-meal, limited federal action to meet some immediate need, which arose, however, out of the increasingly unsatisfactory status of federal-state financial relations. It was, in a sense, a recognition of the inadequacy of the system of per capita subsidies and also a partial adjustment of inequalities between states, since the federal contribution was allocated as to three-fifths in proportion to population and as to two-fifth in proportion to

area. This last provision was of particular benefit to Western Australia, which has the greatest area, with a large part of it virtually unpopulated.

No assistance has been given to the state government railways, but the federal nature of transcontinental railways has been recognized. Provision was made in the Northern Territory Acceptance Act of 1910 for the construction of a line to South Australia, but to date the northern portion of the line extends only 316 miles from Darwin. The southern portion as then existing (Port Augusta to Oodnadatta, entirely in South Australia) was taken over by the Commonwealth, but no progress towards extending it was made until 1926, when an agreement was made with South Australia providing for an extension of 293 miles, constructed at Commonwealth expense and forming part of the federal railway system.

The largest federal undertaking has been the so-called Trans-Australian Railway from Kalgoorlie in the Western Australian goldfields to Port Augusta in South Australia, a distance of 1,052 miles, the line being completed in 1917. The states concerned ceded land for the right-of-way.

,As at June 30, 1935 there were 2,145 miles of federal railways in operation, the total cost for construction and equipment of which was £15,675,000. Since 1929 there has been an average annual operating loss, before meeting interest, of about £75,000.

The various railway systems in Australia have a number of different track gauges, to the detriment of interstate traffic. The first step towards uniform gauge railway communication between state capitals was taken by the Grafton to South Brisbane Railway Act of 1924. The original arrangement is an interesting example of inter-governmental co-operation. The Commonwealth paid the entire cost of relaying part and constructing the remainder (95 miles) of the line, but ownership and operation were vested in the respective railway systems of New South Wales and

Queensland. One-fifth of the cost was deemed to have been incurred on behalf of the Commonwealth, and four-fifths on behalf of the five mainland states in proportion to population. The latter, however, were to be relieved of financial obligation out of surplus earnings of the line, such surplus to be applied in payments to the Commonwealth in respect of interest on the quotas, first of Victoria, South Australia and Western Australia, next of Queensland and New South Wales, and lastly of the Commonwealth itself. However, the three states not directly affected refused to enter into the agreement, and their quotas were assumed by the Commonwealth. The line was opened in 1930, and the total capital cost to June 30, 1935, was £4,364,000.

Two other instances of co-operation and joint expenditures have to do with irrigation and immigration, the former a particular measure to deal with a special situation and the latter a more general project to accommodate conflicting jurisdictions.

The Murray River constitutes the major portion of the boundary between Victoria and New South Wales and then flows through South Australia to the sea. Problems arising from the use and diversion of its waters threatened to result in prolonged litigation between the three states. The difficulties were resolved by the River Murray Agreement entered into between the three states and the Commonwealth in 1914, and brought into operation in 1917. The agreement determined the locks, dams and reservoirs to be constructed and led to the appointment of the River Murray Commission as an administrative body representative of the four governments. The works were to be constructed by the states, with the total estimated cost of £4,663,000 to be borne equally among them except for a contribution of £1,000,000 from the Commonwealth. An agreement of 1923, ratified by the four Parliaments and in force from 1924, enlarged the scope of the undertakings and increased the Commonwealth's contribution to a full quarter share. It has since been estimated that the ultimate cost of the project as a whole will be some £15,000,000.

Federal activity in connection with immigration was for 20 years confined to exhibitions and advertising overseas. This was changed in 1920, when an agreement was entered into with the states whereby the Commonwealth undertook the work of recruiting, selecting, and assisting the transport of immigrants in accordance with advice from the states as to the number and classes they were prepared to receive, and the states accepted the responsibility of finding employment for immigrants or settling them on the land. The Commonwealth undertook all publicity and propaganda abroad. Under the scheme the Commonwealth donated £12 towards the passages of approved settlers. Since 1925 joint contributions have been made by the Commonwealth and United Kingdom at about double the foregoing rate.

In addition, in April 1925 the British and Commonwealth Governments entered into an agreement whereby loan moneys were to be furnished the states at low rates of interest, to enable land to be made available for new or increased settlement or to enable the carrying out of such public works as would tend to develop and expand settlement areas. A maximum amount of £34,000,000 would be provided with a view to the absorption of 450,000 settlers over a period of 10 years, the states being required to accept and settle satisfactorily one assisted immigrant for each £75 advanced. The agreement was accepted by all states, but no large migration took place under the scheme. Administration was vested in the (Commonwealth) Development and Migration Commission, appointed in 1926. After five years of investigation it had been able by 1931 to recommend the expenditure of only £6 millions, and its reports show that it thought much current loan expenditure was uneconomic.

Immigration Statistics

	1921-5	1926-30	1931-35
Total arrivals	478,052	470,480	239,323
Net immigration	173,543	130,058	-10,886
Assisted immigration	115,448	99,403	781

Commonwealth loans to states for immigration, outstanding on June 30, 1928, were £5,195,000, of which £4,315,000 was provided during 1924-28.

VI SPECIAL GRANTS TO INDIVIDUAL STATES

(1) Historical summary

Australia is outstanding among federations not only for the magnitude of payments by the central government to all states upon a uniform basis, but also for the extent to which the special difficulties of two or three states have been recognized as a matter of national concern and alleviated by payments from the national treasury.

Such payments may be summarized briefly as follows: By the Surplus Revenue Act of 1910 the State of Western Australia was given an annual grant for 25 years, commencing with £250,000 in 1910-11 and decreasing annually by £10,000. For 1925-26 such provisions were replaced by a grant of £450,000. The States Grants Act of 1927 provided a grant of £300,000 annually for five years commencing with 1926-27. This was continued in 1931-32, and increased to £500,000 in 1932-33 and £600,000 in 1933-34. In the three subsequent years the Grants Commission awarded Western Australia £600,000, £800,000 and £500,000 respectively.

The Tasmanian Grants Acts of 1912 and 1913 gave that state £95,000 in 1912-13, £90,000 annually for the next eight years, and £85,000 in 1921-22. Acts of 1922 and 1923 continued this sum for two further years. The Tasmanian Grants Act of 1924 provided for payments over a period of five years commencing with £85,000 in 1924-25 and decreasing by £17,000 per annum. In addition, the Commonwealth withdrew from lottery taxation and in 1924-25 handed over to Tasmania the amount of £61,000 already collected in that year. The States Grants Act of 1927 altered the grant to £378,000 annually for 1926-7 and 1927-28. Further Acts granted £220,000 in 1928-29 and £250,000 annually for five years commencing with 1929-30. This again was altered to £330,000 in 1932-33 and £380,000 in 1933-34. For the three following years the Grants Commission awarded £400,000, £450,000

and £600,000 respectively.

South Australia first received a special grant in 1929-30, the amount being £360,000. In 1930-31 the amount was £1,170,000 and in each of the next two years £1,000,000, followed by £1,150,000 in 1933-34. For the three following years the Grants Commission awarded £1,400,000, £1,500,000 and £1,330,000 respectively.

A clearer picture of the size of these special grants in recent years may be obtained from the per capita figures, which are as follows:

	Western Australia	Tasmania	South Australia
1931-32	£ 0.69	£ 1.09	£ 1.73
1932-33	1.15	1.43	1.73
1933-34	1.36	1.64	1.97
1934-35	1.36	1.73	2.40
1935-36	1.79	1.93	2.56
1936-37	1.11	2.55	2.26

All these grants were in addition to other payments received from the Commonwealth under general schemes applicable to all states, such as the per capita subsidies, roads grants, and payments under the Financial Agreement. An important factor in making the grants has been recognition of the claimant states' difficulties by the other states, and support given by the latter and their representatives in the federal Parliament to the claims of the former for special assistance.

Search for the principle underlying such grants prior to 1934-35 is arduous and unavailing, for the Grants Commission itself, commencing its work in 1934 after 24 years of grants, could find none. A claimant state usually based its claim chiefly on the argument that federal policy had benefited other states but injured it. In a minor key it was also suggested that the solvency of each state, and the maintenance therein of the Australian standard of governmental living, were matters of concern to the rest of the nation. Tasmania appears to have

been the strongest protagonist of this second argument, which does not depend for its strength upon the actual cause of a state's difficulties. In Western Australia, on the other hand, this line of argument was reinforced by the growing secession movement which came to a head in 1934.

On the part of the Commonwealth there is little evidence of any consistent principle. The governing consideration seems to have been expediency, leading to temporary ad hoc settlements, in the absence of any apparent inclination to make a far-reaching survey and settlement of the problem -- prior, of course, to the establishment of the Commonwealth Grants Commission. The grants to Western Australia in 1910 and Tasmania in 1912 and 1913 were a partial exception to this statement. These were given in recognition of the fact that these States would suffer more than the others from the reduction in general payments as a result of the substitution of the per capita subsidy for the Braddon Clause payments. In the case of Western Australia, the conference of 1909 which agreed to the new form of payments itself provided for the special grant to that State, "in view of the large contribution to the customs revenue per capita made by the State of Western Australia". This seems to regard the situation not directly as a case requiring compensation for disabilities resulting from federal policy, but as requiring adjustment with a view to each state's per capita subsidy being roughly in proportion to its contribution to federal revenues. With regard to Tasmania's claim, first put forward in 1911, the Commonwealth Year Book for 1912 says that in 1911 a Royal Commission reported on the matter and recommended the payment ultimately made by the Acts of 1912 and 1913, the recommendation being made "in view of the dislocation of the state finances due to federation."

But in any case those early grants were regarded as temporary measures to facilitate a gradual transition to the new system. With the renewed difficulties of these non-

industrial states after the War, Commonwealth policy gives the appearance of indecision and drift, increasingly large amounts being granted as temporary palliatives but without agreement on principle. There was evident disinclination to regard the problem as other than temporary, and grants were usually made for one or two years at a time.

After many years of such temporizing, the Commonwealth Parliament's Joint Committee on Public Accounts, reporting in 1930 on the question of Tasmania's disabilities, recommended strongly that "A permanent body should be appointed to make a continuous study of the financial relations of the Commonwealth and the states", and that "uniform methods and procedure in relation to financial assistance to the states should be evolved", for which purpose "the essential requirement is that all questions of state grants should be referred to the same body for investigation.......a body capable of evolving definite basic principles under which the claims of any state may be measured or assessed from time to time without the necessity for protracted investigation".

In making this recommendation the Committee was following the suggestion of Professor L. F. Giblin, Ritchie Professor of Economics in the University of Melbourne, and later to become a member of the first Grants Commission, made in an Appendix to "The Case for Tasmania, 1930" containing Tasmania's claim for an increased grant. In the following year the Joint Committee's report on South Australia repeated the recommendation, and the Commonwealth Grants Commission was established by statute in 1933. This body is really a Royal Commission, required to inquire into and report upon claims for special grants as made by any State from time to time; it differs from most other Royal Commissions in its character of permanency, and in the fact that Parliament has, up to date, fully implemented its recommendations.

(2) The nature of the Problem

The outstanding factor was, and is, that the governments of the claimant states cannot function satisfactorily without special assistance. However much these states may base their claim upon disabilities suffered from federation and federal policies, they would not have obtained any compensation as such, nor any grant at all, were it not that their public finances were in worse condition than those of the other states. After 1910 all the states functioned with more or less consistent deficits, and it was through the excess of their deficits as compared with the other states, on a per capita basis and in relation to available resources, that the claims of Western Australia and Tasmania, and later of South Australia, entered the realm of practical politics.

Between 1910 and 1927 the States of Western Australia and Tasmania had accumulated crude deficits, after deducting the occasional surpluses, of £6,167,000 and £507,000 respectively; but for their special grants, the same revenues and expenditures would have resulted in accumulated deficits of £9,617,000 and £2,170,000 respectively, as compared with a total of £8,802,000 for the other four states not receiving special grants. On the basis of the mean populations in 1927 the accumulated per capita deficits were:

1910-27 Accumulated Deficits, per capita

	Actual (i.e. with special grants)	Without Special Grants
Western Australia	£15.73	£24.53
Tasmania	2.38	10.19
Other Four States	1.58	1.58

The situation became worse after 1927, and South Australia required large grants as well as the other two perennial grantees. The following table shows the position of state finances in the post-war period, with per capita figures on the basis of mean population in 1935:

1920-1 to 1934-35 Accumulated Net Deficits

	Budget Deficits £000	Budget Deficits per capita	Without special grants £000	Without special grants per capita
Western Australia	7,802	£17.51	12,402	£27.85
Tasmania	1,173	5.11	4,569	19.90
South Australia	9,005	15.39	15,085	25.78
Other three States	56,521	10.37	56,521	10.37

The foregoing figures considerably underestimate the real relative inferiority of the financial position of the claimant states since their deficits were to some extent kept down by unsound methods of account necessitated by the impossibility of meeting certain properly current expenditures, such as maintenance and depreciation on railways, out of revenues; while the deficits of the other states were swelled by the refusal of New South Wales to economize to the same degree as the rest. In 1931-32, for instance, the first year of the Premiers' Plan and the last year of Mr. Lang's tenure of office, New South Wales had a deficit of over £14,000,000, or one-quarter of the aggregate deficits of the "other three states" over the whole fifteen-year period in the above table.

The disparity between states, and the absolute dependence of the weaker states upon direct federal assistance, are perhaps made clearer by comparing such assistance with the amount of the states' tax revenues. The following table covers the post-war period, divided at 1927, and expresses aggregate direct federal assistance to state revenues (namely, per capita subsidy 1920-27, contribution towards interest and sinking fund payments 1927-35, and special grants) as a percentage of total state tax revenues inclusive of taxes paid into special funds:

	1920-27	1927-35	Fiscal Year 1934-35
	%	%	%
Western Australia	53	56	50
Tasmania	57	79	68
South Australia	30	49	69
Other Three States	33	25	24
All States	34	30	31

The Commonwealth payments, large as they bulked in relation to state tax revenues, were only 14% of Commonwealth tax receipts in 1920-27, and 18% in 1927-35.

There were three basic causes, all interacting, for this evident disparity among the states--physical resources, influence of world conditions acting particularly through export prices, and the unequal incidence of federation and federal policy. Subsidiary causes were, in the case of Western Australia and South Australia, certain instances of imprudence in and mismanagement of development projects, and in the case of Western Australia, failure (until recently) to impose as severe taxation as the other states.

The situation is somewhat analogous to that in Canada, if regard be had to the chief differences between the states. On the one hand, New South Wales and Victoria are populous, prosperous and industrialized states with many natural advantages. Although large producers of wheat and wool, such production is small in comparison with other lines of endeavour in sheltered industries producing almost entirely for a protected home market and able to take full advantage both of federal tariff policy and interstate free trade. On the other hand, Western Australia and South Australia are largely semi-arid, except for the coastal strip and the Murray River Basin, and severely limited in productive capacity. (In the first decade of the century Western Australia was a large gold producer, but production dwindled to an average of £2,000,000 per annum in the decade 1921-30; subsequently currency depreciation stimulated production, which showed a steady rise to £7,325,000 in 1936). They have achieved great success in growing wheat by dry-farming methods, and in

the development of sheep suited to the country, but are necessarily largely confined by climate and natural resources to two products, wheat and wool, which must be sold abroad. Such specialization in export production means vulnerability to world influences and inability to charge a portion of their costs on the rest of the country. Moreover, the nature of the climate required costly experimentation before the use and limitations of their territory could be determined; in particular, large capital expenditure by governments on communications and water supply had to precede settlement before it could be known with certainty whether such settlement would be successful. In Australia such expenditure, and notably that on railways, was made by the states, not by the federal government. Tasmania is likewise a non-industrial state. Base metals for a time were a source of considerable income, but were seriously affected by the fall in world prices. Lumbering was also an industry of some importance, but forests are now badly depleted. Settled early, Tasmania for awhile flourished through sale of agricultural produce to the mainland. It is a rugged, mountainous country with abundant rainfall, but limited productive areas. Unlike Queensland, it "has no monopoly of its more specialized products and its comparative advantages have been whittled away by the growth of a self-sufficient agricultural policy in other states". This state has been in a depressed condition for many years.

Finally, Queensland is in a class by itself. It has today a certain amount of manufacturing industry, and fairly large pastoral production (chiefly wool), but the chief factor in its development, particularly of its semi-tropical area, has been the production and milling of sugar cane. It is eminently suited by nature for such production, but could not meet outside competition if it undertook the high cost of white labour without special assistance. The Commonwealth has consistently given such assistance, in early years by sugar bounties and later by

price agreements between the state and the Commonwealth, reinforced by the latter's control of imports. The justification of such assistance has been that it was desired to populate the north, and if the White Australia policy were to be followed, subsidization was necessary. Professor Giblin has stated that this one measure of assistance, which has been on a generous scale and much greater than the protection received by most lines of manufactures in the industrialized states, has sufficed to offset all disabilities of Queensland from other federal policy. He estimated that in 1935 the excess cost of sugar in Australia was £5,100,000, accruing chiefly to Queensland with its population of 970,000, most of whom would not be there in the absence of such protection.

Western Australia, South Australia and Tasmania, the "claimant states", are, then obviously not able to benefit by federal economic policy, and through increase of their costs of production and of living are in fact adversely affected by it. They are at a disadvantage compared with the other states not only because they have to bear such added costs without direct compensating benefit, but because the cost of their own development has necessarily had to be met out of government funds, and only their own government, whereas the cost of development of secondary industry is not a direct charge upon government finances, and is not borne solely by the states affected but is diffused over the whole country. Since this distinction between primary and secondary industry, in Australia as in Canada, is in large degree geographical as well as economic, state finances necessarily would reflect the relative advantages and disadvantages of the two types of production, and particularly in a time of world depression, the first brunt of which is borne by primary production dependent on exports.

The Grants Commission dwells at some length, however, on certain benefits to the claimant states. They remark that the net cost of the tariff cannot be accurately measured, but they

are inclined to believe that it is very largely offset by (a) benefits to agricultural exports and gold production through depreciation of exchange, and (b) excess of Commonwealth expenditure over Commonwealth revenue raised in the claimant states. The latter item of net benefit was calculated at £4.8 million in 1934-35, of which the special grants constituted, in net benefit as opposed to their gross amount, £1.9 millions; the remainder, or £2.9, is described by the Commission as the net benefit under "the normal working of the federal scheme", but for its purposes the Commission takes the figure of £4.8 millions as the actual offset in that year to disabilities from tariff and other policies, in addition to the exchange benefit and various intangible benefits from belonging to a large nation.

Two further points may be mentioned. The difficulties of Western and South Australia have not been enhanced during the depression by unusual drought. Throughout the period of low wheat and wool prices, rainfall was on the whole better than average and production increased. Secondly, the Commission found that these two states had been to some extent the authors of their own harm, through several notable instances of injudicious development projects and mismanagement of one or two others which with careful management might have been completely successful.

(3) The Principles adopted by the Grants Commission

Each year, in supporting their claim for special assistance, the states continued to emphasize that they felt they were unduly burdened by federal policy which chiefly benefited the industrial states,and that they were entitled,as of right,to compensation. The Commission,however,has refused to accept this as the principle on which to base its recommendations.

In its first report (1934) the Commission pointed out that it was extremely difficult,and in its view impossible,to measure directly with any accuracy the net disadvantages to a state resulting from federation and federal policies. Moreover, such

disadvantages accrue more to the people of the state, not directly to the state treasury. The Commission was concerned not with assisting or compensating regions or industries, but with recommending grants to augment the revenues of state governments, and it was obviously impossible to measure directly the effect on state finances of the disabilities of the people. But it was held that such disabilities would be reflected in the condition of state finances by comparison with other states, after adjusting for differences in budget accounting, tax severity, and scale of expenditures. After making such adjustments, the Commission held, the resulting degree of comparative inferiority, measured in revenue deficit per capita, would completely reflect the effect of such disabilities on state finances, and therefore the measure of such inferiority would give the crude basis of the measure of the grant required. It would, however, be greater than the mere effect of the disabilities from federation, for (in the Commission's opinion) it would also include the effect of relative inferiority of natural resources, and greater than average losses on loan works and state business undertakings. The Commission justified the inclusion of such items in the measure of the grant required, except losses arising from mismanagement and extravagance.

The line adopted in the first report was admittedly tentative, and in the second report, while the same basis of measurement was adopted, the emphasis was shifted with regard to the underlying principle. It was now held that the reasons for a State's relative financial inferiority were irrelevant--the grants must be made in order to maintain certain standards throughout Australia. Disabilities from federal policy might be of interest as explaining, in part, the cause of the state's difficulties, but compensation for such disabilities had no bearing, even indirectly, upon the principle justifying special grants.

This view was adopted as the permanent basis in the third report (1936) and seems now well established despite the states' continued insistence on their right to compensation. The Commission was no doubt fortified in its determination to negative the principle of compensation by the calculations it made which purport to show that compensation would not give as great a sum as a grant based on need. "Redressing the inequalities of the financial position of the states by special grants affords all the special relief necessary for the differential effects of federal policy on the people of different states." Here again it might be claimed that such would not be the case except in time of depression, but the Commission has firmly stated that there will be no grant at all if the only claim that can be made is for compensation, that is, if the claimant states are in a position where state finances are as satisfactory, on the basis adopted, as those of the other states.

The Commission has, in fact, developed a new philosophical justification for special grants, making them essentially charitable, from the point of view of the recipients, but acts of necessary self-preservation from the point of view of the Commonwealth as a whole. The principle is explained in chapter VI of the third report as follows:

"Special grants are justified when a state through financial stress from any cause is unable efficiently to discharge its functions as a member of the federation and should be determined by the amount of help found necessary to make it possible for that state by reasonable effort to function at a standard not appreciably below that of other states."

The extensive system of distribution of part of federal revenues to all states, from the beginning of federation, is described as "an accepted practice of transferring large and increasing sums from Commonwealth to state governments, primarily because the Commonwealth can raise the money more easily. All these transfers have had some effect in helping the weaker states,

and this has been, in part at least, the avowed purpose of some of the transfers............ Special grants are then continuous in principle with other transfers of Commonwealth revenue to the states. They should be the amount required to complete the work begun by other transfers, and to reduce the financial inequality of the states sufficiently for the harmonious and effective working of federal government."

The Commission nevertheless seems to find it necessary to justify grants, in some part, by the nature of the causes of financial inferiority, including disabilities from federal policy if the latter actually have an adverse effect on state finances. "The necessity of special grants arises from two different considerations. The financial scheme of the Commonwealth coupled with certain economic causes tends to produce inequalities as between the states, and where these are sufficiently severe some states find it impossible by their own efforts to discharge their functions with reasonable efficiency. In such circumstances, there is a case for rectifying the inequalities."

"States may also become so embarrassed financially by various causes, apart from the operation of federation, and sometimes by their own faulty policy, that they are unable properly to discharge their functions to their citizens or to the Commonwealth. Whenever they are in this position we say that special grants should be made......Thus we base special grants on needs."

"The law of self-preservation is fundamental. A federation lives only while its constituent governments live. If one of the governments becomes, or threatens to become, unable for financial reasons to discharge its proper functions adequately, it is a first necessity for the federation to give such help as will make it possible...Without such help, the state must default. The Commonwealth is ultimately responsible for state debts, and is bound to meet all interest under pain of itself defaulting." (This last sentence refers to the obligations of the Commonwealth under the Financial Agreement of 1927)

"Our method aims at a fairer apportionment of the financial resources of the Commonwealth.......All financial adjustment within a federation is a means of distributing in a rational way the total financial resources of the group. It should not be regarded merely as a means of assisting states in difficulty."

"If a state is in financial difficulties it must be made possible for it by a "reasonable" effort to get as good financial results as other states. The payment that will make it possible will be the special grant, and, if this can be estimated in a satisfactory way, the grant so determined will fully and adequately meet all claims that can properly be made for special grants for any cause whatsoever."

(4) The measurement of the grant.

An important element in the Commission's method is to determine the "reasonable effort" which a state is expected to make to attain financial stability, before a special grant will be made--or rather, as an offset to the amount of the grant as measured by actual need.

The Commission decided that taking an average of conditions in Victoria, with a settled policy of great economy of administration and low taxation, and in Queensland, which makes more liberal provision of services through high taxation, would give a ""normal" standard for Australian state governments under present economic conditions." New South Wales was left out of consideration, in the more definitive and permanent methods adopted in the third report, as it "exhibits so many disturbing features."

The Commission holds that no state should be required to endure much less than the normal standard of expenditure nor much more than the normal standard of taxation. The scope for economy in expenditures is regarded as very limited; debt charges cannot be reduced; salaries should not be reduced "much below the corresponding rates in private employment" and in any case most such expenditure is in railways where rates are fixed

by the Commonwealth Arbitration Court; reduction in personnel has already gone as far as it can. Thus the minimum effort, under present conditions, "should be equivalent to about 6 per cent on social services, which is about 3s per head of population", and even the maximum effort "should involve only a moderate departure from the normal". Maximum effort is measured in terms not of economies, but of taxation. There is automatic adjustment of the grant according to the extent to which severity of taxation in a claimant state is greater or less than normal, but in addition such a state will have a deduction from its grant, according to circumstances, by way of requiring it to make the "maximum effort". Such a deduction is not imposed as a matter of course, but only where it is deemed proper to demand greater than minimum effort of the state as a penalty for past extravagance or mistakes, such penalty to be tempered, however, by mercy in the case of a long history of adversity, or unfavourable future prospects. The maximum penalty is not great, for the chief source of taxation revenue is the income tax, in which "great differences between the states easily divert capital and employment from one state to another", a diversion which it was not desired to encourage. The Commission accordingly felt that no state should be required to increase its income tax much above the normal, and decided that "the maximum effort should be equivalent to 10 per cent on severity of taxation".

"The 'reasonable' effort required of any state would then be equivalent, roughly, to 6 per cent reduction below normal social services with in addition an increase in severity of taxation of anything from 0 to 10 per cent of the normal, according to circumstances. These circumstances should be judged very generally, and should include not only the state's record of mistakes and extravagances beyond the average, but its previous history of adversity and its prospects of coming prosperity".

This does not mean that the state must actually make the exact amount of economy in expenditure, or increase in taxation.

The amount so measured is deducted from what would otherwise be the grant, and it is left to the state to institute such economies or higher taxation (or greater expenditures or lower taxation, in some cases) as it sees fit, in order to bring its budget, when assisted by the grant actually made, more or less in line with the "normal". It is not a condition of the grant that the state should actually make any change at all in its taxation or expenditure, but the grant is so calculated that the state will be unable to keep its deficit as low as the standard deficit unless the indicated "effort" is made. However, the Commission's Reports themselves speak of "requiring" that such effort be made, and similar language has accordingly been used in this memorandum. It is said that pressure of public opinion has in fact caused the claimant states to make some of the adjustments indicated, although so far the changes effected have been increases in taxation rather than reductions in expenditure on social services.

The working out of such principles in assessing the grant for 1936-37 may be of interest. Each of the three claimant states was required to make an effort towards bettering its financial position by reducing its social expenditure to 94% of normal, if it were above such a figure. No additional taxation effort was required of Tasmania. South Australia was assessed an additional effort of 7% on normal severity of taxation, on account of past excesses and mistakes in loan expenditure. (But since actual taxation was even greater than the figure so arrived at, the grant was increased by the amount of the excess). For the same reason Western Australia would have been assessed 10%, but this was reduced to 7% because "we think the Commonwealth has some special responsibility on account of the development of the north-west of Western Australia," and was further reduced to 5% on the ground that, although it is not admitted that the burden of the tariff outweighs net benefits from Commonwealth revenues and

expenditures, nevertheless such burden is greater in Western Australia than in South Australia.

Such measurements of additional effort were then deducted from the needs of the states as measured by relative budget position. In assessing such needs, the starting point is the per capita deficit of a claimant state as compared with the standard deficit, i.e. the average of Victoria and Queensland. The published deficits are adjusted for differences in methods of accounting, and, of course, the deficits of the claimant states have to be increased by the amount of the special grants in the year in question, in order to arrive at the total grant needed. (There is an inevitable lag of two years. Thus in assessing, in 1936, the grant for the year 1936-37, the final financial statements for 1934-35 were the latest available.)

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The various deficits having been made comparable with each other, and the standard deficit calculated, it is then necessary in order to arrive at the "real" budgetary position, to make further adjustments in order to bring all states to a common standard of taxation and expenditure. The chief adjustments for the claimant states were for deficient allowance for maintenance and depreciation of capital equipment, undue or insufficient cost of administration and expenditures on social services, and undue or insufficient severity of taxation and scale of charges for services.

Measuring comparative severity of taxation was a complicated calculation, involving construction of comparable indices of actual taxation and of taxable capacity, the ratio of the former to the latter being defined as the severity index. Finally, the penalties already described are applied to such index for each state. Thus the "normal severity" index (average of Victoria and Queensland) was 101. South Australia's penalty of 7% made the standard required of her 108. It was found that the index of actual severity in South Australia was 112, or an excess of 4. To the amount of South Australia's deficit was therefore added 4/112 of her actual taxation, being one of the adjustments to arrive at the comparable budget deficit which would be brought to standard by the special grant.

The series of additions and subtractions which were used in arriving at one state's special grant for 1936-37, namely South Australia, may then be summarized as follows: The published financial result for South Australia in 1934-35 was a surplus of £36,000. Without the special grant received in that year there was a deficit of £1,364,000. There was also a non-recurring special distribution to all states by the Commonwealth, without which South Australia's deficit would have been £1,540,000. Corrections were then made with regard to accounting methods,

bringing the deficit to £1,409,000 or £2.412 per head, as compared with a "standard" deficit of £0.364. So far, the grant required would be £2.048 per head, or £1,196,000. Maintenance of capital equipment was then considered, but no adjustment was deemed necessary. Next, it was held that the costs of administration were too low, and £20,000 was added on that account. With regard to scale of social services, it was found that the standard for the average of 1933-34 and 1934-35 was 53s 10d per head. The penalty of 6% as "minimum effort" reduced the allowable scale to 51s 7d. South Australia's actual expenditure was just equal to this, so no adjustment was necessary. Next, excess severity of taxation (i.e. the excess above the sum of the normal severity plus the "penalty" of 7 per cent for past mistakes) was allowed for, amounting to £115,000, which was added to the amounts of £1,196,000 and £20,000 previously mentioned, and the total of £1,331,000 was then described as the amount necessary to adjust the financial position of the state to "a standard which the Commission considers just"; the actual grant recommended was £1,330,000.

(5) Some comments on the new system of grants

From the foregoing, and especially from the greater details presented in the Commission's Reports, it appears that the assessment of the grant is a complicated procedure. An outsider might not place a great deal of confidence in many of the calculations relied on, particularly the approximations and estimates, and the allowances and deductions for immeasurable factors, but the Commission readily admits the faults of its procedure, and relies on cumulative experience and further adjustments to rectify them.

Perhaps the most striking feature of the method of assessment is that grants are so calculated as to enable all the claimant states to have approximately the same level of governmental revenues and expenditures, on a per capita basis, but that this level should be determined not by any absolute standard but

by the standard set by Victoria and Queensland. The first comment on the use made of the principle of "fiscal need" is, therefore, that the basis adopted is not actual need, but hypothetical. If Victoria and Queensland, from choice or necessity, have large deficits, then so must the claimant states, so far as concerns the calculations used in determining the grants;and such states must in fact have large deficits in such circumstances unless they are prepared to increase taxation or reduce expenditures far beyond the limits suggested as practicable by the Grants Commission. It seems therefore, that it is essential that these states be able to borrow money to cover their deficits, and it may be doubted whether the new system of grants could have achieved its purpose in the absence of the Financial Agreement and the Premiers' Plan. Another difficulty would arise if Victoria and Queensland had large surpluses, but this objection is probably academic in view of the ingrained habit of deficit-financing among the Australian states.

Secondly, a critic might point to the departure from the basis of fiscal need involved in the assessment of penalties for mistakes and extravangance. That a state should pay for its mistakes is easily justified on moral grounds, but reducing the grant on that account is directly contradictory of the high reasons of state given by the Commission as the basis for not allowing any component of the nation to default on its debt or to fall below the Australian standard. However, the Commission expressly limits its definition of needs to the needs of a state after it has made a "reasonable effort" as previously defined.

The rejection of the principle of compensation was based in part on the difficulty of measuring the disabilities for which compensation could be claimed,and on the "natural" compensation resulting from expenditures by the Commonwealth in a claimant state being greater than Commonwealth revenue raised in that state. On the first point, the chief difficulty was, of course, the dearth of statistics. The Commission has neither

undertaken itself nor recommended that any other body should undertake the rectification of this lack, for it takes the view that the whole matter of the effect of tariffs and other federal policies on the finances of state governments is extremely complicated, and depends not only on statistics but on economic reasoning of a very controversial kind, so that it is impossible to conceive of any statistics which would answer the question.

The Commission, in considering the general question of the burden of excess costs created by tariffs, embargoes, and price-fixing agreements, likewise did not take into account that such burden is not limited to the actual cost in any year, but includes the restriction of production which could be profitably carried on were it not for the tariff, which affects not only the profits derived from land, for example, already under cultivation, but also the potential area of economically usable land.

An argument emphasized in all three Reports was that Australia as a whole had decided on a certain fiscal policy with a view to the development of secondary industry at the expense of agriculture, and that it would be self-stultification for the Commonwealth to give compensatory grants to states not benefitting from such policy, for that would cause interference with movement of capital and labour which should normally take place under such a fiscal policy. This argument, it would seem, is equally inconsistent with the principle of making grants in accordance with fiscal needs, on the basis adopted by the Commission, although the Commission attempts to distinguish between the two methods on the ground that making grants to a state government (even though with the avowed objective of enabling it to levy less taxes or provide greater benefits for its citizens than would otherwise be the case) does not interfere with economic tendencies, a somewhat doubtful assumption under modern conditions, and especially in Australia. (It is true that the grants do not enable the claimant states to levy less taxes than the other states, so that the effect is not to give the

claimant states a competitive advantage over the others, but rather to remove a disadvantage, a process which, so far as it goes, seems to be much the same thing in relation to counteracting the effects of federal policy.) It is apparently assumed that compensation for disabilities would have to be made direct to the individuals concerned, e.g. wheat farmers, and not to state governments, and that all wheat farmers including those in the industrial states would have to be equally benefited thus interfering with the economic balance within the industrial states themselves as well as between the different sections of the country. The claimant states, although highly specialized, only produce about 40% of the wheat and 20% of the wool of Australia as a whole, so that the problem of compensation to the export industries most injuriously affected by the tariff seems to the Commission to cut across state lines. The point does not appear to have been raised that compensation to agriculture in a state benefiting from the tariff might be made by such state itself; such action would not take away the benefit of the tariff but leaves it to the state concerned to determine the internal distribution of the benefit.

The measurement of compensation from normal Commonwealth expenditures would be worthy of closer examination if it were decided to base special grants, in part at least, on the principle of compensation. As already mentioned, out of a total net benefit to the three claimant states in 1934-35 of £4.8 million, as found by the Commission, £1.9 million consisted of the net benefit from special grants; the remainder included an amount of £1.2 million as the net benefit from relief to primary producers. The latter was a special depression payment which has now ceased. The former is scarcely a compensation resulting from the normal workings of federation, and was not so designated by the Commission. The remainder, or £1.7 million, is made up of a number of different items of which the largest is federal aid to roads (net benefit £433,000). Service of debt for public works and service of war debt, and annual defence expenditures were all allocated on a population basis. Professor Giblin has pointed

out (in his addendum to The Case for Tasmania 1930) that Tasmania could not have made war expenditures by itself on a scale commensurate with that of the country as a whole, and that the foregoing bookkeeping method was not applicable. The states, however, have refrained from objecting on this score.

Finally, it may be pointed out that the Grants Commission, and earlier ad hoc bodies dealing with grants, did not have to report upon such broader questions as re-division of constitutional powers and responsibilities. They were not called upon to produce a plan of adjustment of federal-state financial relations generally, which necessarily depend upon the interaction of constitutional provisions and general governmental policies, but simply to bring about appeasement of particular difficulties arising from the degree of inequality between states under the existing constitutional, financial, and political organization of the nation.

<u>Note:</u> Since the foregoing was written, the Fourth Report (1937) of the Commission has come to hand. Two of the three members of the original Commission had retired and their places taken by new appointees. The general principles enunciated in the Third Report are repeated by the new Commission, but an important change was made in their application through the inclusion of New South Wales along with Victoria and Queensland in determining the "standard" used in measuring the grants. But for this, the grants for 1937-38 would have had to be substantially reduced. The larger deficit per capita of New South Wales operated to the disadvantage of the claimant states, but this was a small matter compared with the higher standard of social services and lower standard of taxation which resulted. On this point the Report says (page 87):

> "Without the inclusion of New South Wales the grants would have suffered a substantial reduction. By the inclusion of that state the grants are lower than in the previous year, but not seriously low. It is fortunate, therefore, that the present year offers a very good opportunity to adopt a course which is logically right, but which could not be followed before because of disturbing features in the finances of New South Wales."

The grants recommended for 1937-38 are shown below, together with those for 1936-37. The new grant to Western Australia is inclusive of a so-called "advance" of £136,000, being a special addition to the grant in view of the probable effect of the 1936-37 drought in that State on its finances in 1937-38.

	Western Australia	South Australia	Tasmania
Grant for 1937-38	£575,000	1,200,000	575,000
" " 1936-37	500,000	1,330,000	600,000

It can be calculated that but for the inclusion of New South Wales in arriving at the standard, the "advance" to Western Australia, and a new allowance with respect to social services whereby the scale is adjusted for lesser density of population in the claimant states and consequent higher per capita costs, the grants would have been less than the previous year by about £700,000, or 30%, whereas the actual total reduction was only £80,000, or 3-1/3%.

With respect to the states' attitude towards the principle of needs rather than the principle of compensation, the Commission says (page 12):

> "Tasmania accepts the principle unreservedly. South Australia qualifies its acceptance by reserving the right to revert to a claim based on other grounds if another authority were appointed to determine the grants. Western Australia adheres to her claim for a grant on the ground of disabilities. It is noticeable, however, that none of the states has adduced any evidence before the new Commission designed to prove any claims arising from disabilities, nor was the new Commission asked to revise any of the main conclusions, to discard the main principles, or to alter the methods radically."

VII. THE FINANCIAL AGREEMENT OF 1927

The culmination towards which nearly all developments in federal-state finance in Australia now seem inevitably to have been leading, came about in 1927. After years of fruitless negotiation to overcome the difficulties and dissatisfaction, on both sides, over the per capita subsidy, after a period of endless bickering, accompanied however by increasingly intimate relations between federal and state finances characterized by several forms of co-operation which only served to emphasize the dependence of the states on federal assistance, a definitive solution finally was achieved virtually under duress. In 1926, a month after the conference in May of that year failed to agree on the 1923 scheme (see below) which had formerly appeared acceptable to all states except New South Wales, the Commonwealth Government announced that the per capita payments would be terminated. The states Grants Act of 1927 repealed the Surplus Revenue Act of 1910 and in its place substituted, for one year only, (1927-28), lump sum payments which were actually the same as the states would have received under the earlier Act, and for the future provided only for payment of actual surplus revenue, in proportion to population.

The relationship between federal and state finance in Australia had from the first been unique among truly federal nationa. The course of the development from 1901 to 1927 has been traced in previous sections, commencing with the constitutional provisions whereby the federal power was given the major source of public revenue but was only required to assume very limited responsibilities, under the conditions of that time, so that it had a very large surplus revenue which the states claimed and obtained as a matter of right. Since 1901, however, the expansion of Commonwealth activities, the vast expenditures of the War, the evolution of the nation as an international entity, and the inevitable acceptance of the view that the whole is greater

than its parts, have given the Commonwealth a power and prestige which dwarfs that of any state, and indeed of the aggregate of the states.

Twofold sovereignty, true federalism, might yet exist under such circumstances with a considerable basis in practice as well as in theory, were it not for other factors. One of these relates to inequality between states, considered in the preceding section, an inequality arising from differences of physical conditions and the differential effects of national policy, greatly aggravated by the world depression. The weaker states are not only more dependent than the others on the central power in the degree of assistance which they must receive if they are to continue to function at all, but they are subjected to a needs test from which the others are exempt, and to a very real though indirect control over their budgets by the Commonwealth Grants Commission whose decisions determine the amount of special assistance they receive and which bases such decisions on certain standards of taxation and expenditure. The question for present consideration, however, relates to the position of the states as a group vis-a-vis the Commonwealth, to the common or generic elements of the federal-state relationship. The significant characteristic of that relationship, prior to 1927 at any rate, was the absence of effective independence of the states. Their dependence resulted from the interaction of the provisions of the constitution, the refusal of the people of Australia to alter those provisions, and the actions of the states themselves in refusing to surrender in practice a measure of their legal rights over fields of activity which they could not develop with the aid of their own financial resources alone. Such dependence was manifested in the magnitude of the cash payments by the Commonwealth in aid of state revenue, in the extensive reliance on the credit of the Commonwealth to obtain loans for the states, and in the acceptance of various forms of ad hoc

assistance from the Commonwealth for projects carried on by the states.

The financial provisions of the constitution gave to the new central government what had up to that time been the chief support of public finance in Australia, indirect taxation, and gave it concurrent powers of direct taxation. That is almost inevitable in any federation. On the other hand, the very evident desire of the states to retain as large a measure of sovereignty as possible was manifested in the division of jurisdiction, whereby specific powers were allotted to the federation and all others were reserved to the states, including those requiring, under Australian conditions, the largest expenditures. The large public debts already incurred were left with the states as well as the power and duty of carrying on activities the cost of which necessitated great increases in such debts. In such circumstances, the states needed to secure the major part of customs revenues, and such was secured for them, but only for ten years certain. When, however, that time expired and changing conditions then and later indicated the need for adjustment of either the financial or the functional provisions of the constitution, it was found impossible to secure the acquiescence of the electors in any far-reaching amendment. Insertion of the terms of the Financial Agreement of 1909 into the constitution was rejected as harmful to the development of a strong central government. On the other hand, the necessary measure of support could not be obtained for amendments designed to increase the functional powers, and therefore the responsibilities, of the Commonwealth. Referenda were taken in 1911, 1913 and 1919, in each case with negative result. The two proposed amendments in 1911 were designed to give the Commonwealth unlimited legislative power over trade and commerce, over all corporations, over all matters affecting labour and employment, and over trusts and monopolies including nationalization thereof. In 1913 the same proposals were submitted as five

separate amendments, together with another amendment giving the Commonwealth jurisdiction over conditions of employment and settlement of labour disputes in the several state railway services. In 1919 the proposed amendments related to industrial disputes and nationalization of monopolies. In 1911 the voting was negative in every state except Western Australia, with a 60% negative vote for the country as a whole. In 1913 there was much greater support for the six amendments, with a favourable majority in Queensland, South Australia and Western Australia: the average negative vote over the whole country was only slightly over 50%. In 1919 voters in Victoria, Queensland and Western Australia supported the two amendments, with again a bare majority opposed in the country as a whole.

The final factor was the desire of state governments to retain control of the various activities which they carried on with financial assistance from the Commonwealth. A notable instance was that of soldiers' settlement. As a measure arising out of the War and of the dispatch of soldiers overseas, necessitating some assistance in readjustment upon their return, this would be a responsibility of the Commonwealth, but the chief means of rehabilitation was obviously assisted land settlement, so that the co-operation of the states was required. The latter insisted on full control of all settlement, and the development which must precede and accompany it; the financial provisions upon which agreement was reached provided for joint sharing of the outright assistance given to settlers (reduced interest charges for five years) with the states alone bearing the ultimate responsibility for development costs, for governmental debt incurred, and for any losses that might accrue with respect to loans to settlers. In this instance the various losses were substantial and the Commonwealth voluntarily paid one-half of the unforseen losses of £15 millions (Gross losses to 1927 amounted to £23.5 millions). Another example of the conflict between state particularism and the need for financial assistance

was in relation to immigration and associated land development schemes. State railways may be another example. Clause 33 of section 51 of the constitution empowers the Commonwealth to make laws with respect to "The acquisition, with the consent of a state, of any railways of the state on terms arranged between the Commonwealth and the state". Railway policy has been so closely connected with land development and settlement, which the states have insisted on keeping in their own hands, that little use has been made of this provision.

From 1910 to 1927 the chief controversy between Commonwealth and states related to the general scheme of direct federal assistance to state revenues. The per capita subsidy might have worked satisfactorily in the absence of the disturbance to government finance resulting from the War. The success of such a plan depended really on the voluntary withholding of federal action from the field of direct taxes, a form of self-denial which ended with the War when customs and excise revenues were inadequate to meet the needs of the Commonwealth. At the same time, the imposition of direct federal taxes tended to overcome the regressive effect of customs and excise duties, which bear more heavily upon the smaller incomes, in contrast to the familiar upward gradations of the income tax and its complete exemptions of small incomes. Thus several prominent Australian economists (notably Professors Giblin and Mills) have spoken very favourably of the general system of per capita payments, which they regard as raised, through Commonwealth taxation, in accordance with taxable capacity and, through distribution on the basis of population, as tending to favour the poorer states at the expense of the wealthier. In addition, the system possessed, potentially, though not as actually carried out, the advantage of flexibility, for the amount of the payment could easily be adjusted to changed circumstances; and it could readily have been co-ordinated with any scheme of Commonwealth assumption of state debts.

Between 1910 and 1926 however, no such adjustment was

made. Both sides were dissatisfied, and each proposed new schemes which were departures from, rather than adaptations of, the Act of 1910. In 1919 the Federal Treasurer proposed to reduce the subsidy, over a period of six years, to an annual payment of 10s. This proposal grew out of the anxieties of the financial situation of the time, which soon improved, so far as concerned the Commonwealth, and the proposal was not heard of again. In 1923 three proposals were made, the first by the Commonwealth for abolition of per capita payments and payment of interest on the transferred properties, in return for abandonment by the Commonwealth of taxation of incomes under £2,000 per year. This was rejected by the states, who asked that the Commonwealth retire altogether from income taxation, and cease paying the subsidy, in return for which the states would surrender their moral claim to a share of customs revenues or its equivalent, and would reimburse the Commonwealth for any losses suffered under such a new arrangement. Tentative agreement was then reached, New South Wales dissenting, on a compromise proposed by the Commonwealth, augmenting its original proposal by offering to abandon income tax except for a maximum rate of 12½% on companies, but subsequently the plan fell through.

Throughout this period the most significant feature of the negotiations was the evident determination of the Commonwealth Government to abolish per capita payments. The states, having no legal rights to such payments and being definitely in a constitutional position of financial inferiority, were on the defensive, and forced to rely on a "moral right" to some share of Commonwealth revenue.

Matters came to a head in 1926. In June of that year Dr. Earle Page, the Commonwealth Treasurer, brought in the government bill to abolish per capita payments, and announced a new proposal, namely, for the Commonwealth to

abandon entirely land taxation, estate duties and entertainments taxes and 40% of income taxation on both companies and individuals. He declared it was a "vicious principle" for one authority to raise money for another authority to spend. The bill was not further advanced until March, 1927. At that time the Prime Minister, Mr. Bruce, criticized the existing system from the point of view of the financial insecurity of the states, subject as they were to the arbitrary power of the Commonwealth to cut off all payments; the bad principle of one government spending the revenue raised by another; and in his view, the inequity of making payments on a population basis which he believed favoured the more populous, industrialized, and tariff-protected states.

Whatever the merits of these arguments, the states were in no position to resist a Commonwealth Government determined on a change. Mr. Bruce invited them to a conference in June 1927 for the purpose of discussing the problem of financial relations in its broadest aspects, and apart from previously suggested solutions. The proposals of the treasurer the previous year were discarded along with the others, and new Commonwealth proposals on entirely new principles formed the basis of the agreement of July 1927.

Like that of 1910, the agreement of 1927, put into writing in formal terms in December and now referred to as "The Financial Agreement", envisaged a constitutional amendment and permanent establishment. In the interval the essentials of the scheme were put into effect voluntarily through ratification of the agreement by the various parliaments. The requisite amendment to the constitution was approved by referendum in 1928, and the Agreement became binding upon passage of the Financial Agreement Validation Act of 1929.

From the legal standpoint, the entire scheme hinged upon the provision for assumption of states' debts by the Commonwealth, a matter which had been of little importance in

the discussions prior to 1927, compared with the disputes over the amount of subsidy and method of its payment. Taxation was entirely omitted from the agreement, and the new form of subsidy was made a branch of the debt settlement, amounting, in fact, to a reduction in the interest payable by the states in respect of their public debt, no part of the subsidy being actually paid over to the State Treasuries.

The amendment consisted in adding to the constitution sec. 105A, empowering the Commonwealth to make agreements with the states with respect to their public debts, including the assumption and management thereof by the Commonwealth; the payment of interest and the establishment and management of sinking funds; consolidation, renewal, conversion and redemption of such debts; indemnification of the Commonwealth by the states; and future borrowings by either party. The Commonwealth Parliament was authorized to make laws for validating any agreement already made, and for the carrying out by the parties to any agreement of their obligations thereunder. Finally, all such agreements are to be binding on the parties, subject to variation or rescission "by the parties thereto".

In pursuance of such authorization, the Financial Agreement Validation Act of 1929 was passed by the Commonwealth Parliament, and the new system, already in operation as from July 1, 1927, was given permanent effect.

The provisions (printed in full in the Commonwealth Year Book, and in the Report (1929) of the Royal Commission on the Constitution) are complex and detailed. Beginning with the least complicated, they may be summarized as follows:

<u>(1) Transferred properties</u>

By clause 4 of Part III the states agree to issue freehold title to the Commonwealth in respect of former state properties transferred at federation, in return for which the Commonwealth assumed all liability for principal, interest and

sinking fund in connection with £10,924,000 of state public debt bearing interest at 5% per annum, the amount in respect of each state being specified.

(2) Payment of interest on state debts

By clause 2 of Part III the Commonwealth will pay to the bondholders the interest on all state debt assumed by the Commonwealth.

For a period of 58 years from July 1, 1927, an amount of £7,585,000 annually will be provided by the Commonwealth itself toward payment of such interest. (This amount is equal to the estimated per capita payments for 1927-28). The balance necessary to meet interest on such debt and on any future borrowings by the Commonwealth on behalf of any state is to be paid by each state to the Commonwealth, and after 1985 the whole interest charges on any such debt still unpaid are to be paid by the state to the Commonwealth.

(3) Sinking funds

By clause 3 of Part III sinking funds are established for the "net public debts of the states as existing on 30th June 1927", with annual contributions designed to liquidate such debts by 1985. The Commonwealth must make an annual contribution, from revenue, of 2s 6d for each £100 of such net debt, and each state a contribution from revenue of 5s. In case of new loans for conversion, renewal or redemption of such debts, sinking fund contributions shall continue as though there had been no such conversion, renewal or redemption.

A sinking fund shall be established at the rate of 10s. per annum for each £100 of the amount of new loans (except those for conversion, etc.) raised by or for states, the Commonwealth and state concerned each contributing 5s. from revenue for 53 years from the making of each such loan, except where any such loan is raised to meet a state revenue deficit, in which case there will be no Commonwealth contribution and the state shall pay from revenue each year into the sinking fund

not less than 4% of the amount of such loan until an amount sufficient to redeem the loan at maturity has been accumulated.

Where any state loans money to public or other bodies, any amounts repaid must not be put into consolidated revenue but must be paid either to the state's Loan Fund or to the fund from which the advance was made, or to the sinking fund, and in addition the state must continue its annual sinking fund contribution from revenue, in respect of the loan from which the state obtained the moneys so advanced -- except that where the advance was to a public or local authority and repayment is made by that authority out of revenue, the state may apply such repayments on its sinking fund contribution in respect of the loan moneys so advanced.

All sinking funds are to be controlled by the National Debt Commission, and the required annual contributions are debts payable to the Commission. All moneys and securities in state sinking funds at June 30, 1929 must be transferred to the Commission, except sinking funds subject to statutory or contractual obligations which preclude such transfer, in which case the existing authorities shall retain ownership and control and shall receive the annual contributions from the Commission.

Sinking fund contributions shall not be accumulated in the usual manner, but shall be applied by the Commission to the redemption of the public debts of each state and of loans raised by the Commonwealth for such state, or to the purchase of securities constituting such debts; any securities so redeemed or purchased shall be cancelled, but sinking fund contributions in respect thereof shall continue and in addition the state shall make from revenue a further contribution at the rate of 4½% of the face value per annum (in effect, a payment in lieu of interest) for the full period for which the sinking fund contributions were originally required to be made.

(4) Assumption of states' debts

In pursuance of clause 1 of Part III, the Commonwealth on July 1, 1929, took over the balance then unpaid of the "gross public debt of each state existing on 30th June, 1927", and all other debts existing on July 1, 1929 which under the Agreement are deemed to be moneys borrowed by the Commonwealth on behalf of the states; and assumed "as between the Commonwealth and the states the liabilities of the states to bondholders".

The "gross public debt of a state existing on 30th June, 1927" is defined in clause 2 of Part I, where a specific amount is set forth for each state. The total for all states was £672,120,415, of which £91,459,232 consisted of the then outstanding debts of the states to the Commonwealth.

Such amount of gross public debt included the whole of each state's debt except "any moneys raised by the state by way of overdraft, fixed deposit, or special deposit for temporary purposes only".

(5) The Loan Council and Government Borrowing Powers.

Clause 3 of Part I established an Australian Loan Council, consisting of Ministers or other representatives of the Commonwealth and states, one for each government, and each with one vote except the Commonwealth representative who has two votes and a further casting vote. Every decision of the Loan Council, within its jurisdiction, is binding on all parties to the Agreement.

The Council's powers of control commence with the requirement that the Commonwealth and each state shall submit to the Council a programme setting forth the amount it desires to raise by loans for each financial year, including separately loans to cover revenue deficits, but excluding loans for conversion, redemption or renewal of existing loans or for temporary purposes. The programme must also state the estimated loan expenditure for the year. (A separate statement of each year's requirements for conversion, etc., must also be presented).

The Council may then either approve the total amount of all such programmes, (exclusive of the conversions, etc.,) or if it decides that such total amount cannot be borrowed at reasonable rates and conditions, it may fix some lesser total amount, and may then by unanimous decision allocate such amount among the various governments. Failing such unanimity as to allocation, the Commonwealth is entitled to have up to one-fifth of the total allocated to it; the balance is divided among the states in proportion to their net loan expenditure during the previous five years; if any state does not require its full quota, the excess is divided among the others on a similar basis.

The Council not only has control over total borrowings in any year and allocation thereof, but also, by unanimous decision, over the allocation of the proceeds of each separate loan during the year, subject, of course, to the requirements of the allocation of total borrowings. Failing unanimity, the proceeds of each loan are allocated in the same proportions as the allocation of total borrowings for the year.

Except where a unanimous decision is specifically required, decisions of the Council are by "a majority vote of the members". A "unanimous decision" apparently requires concurrence not only of members present at a meeting but of all the members for the time being of the Council. An absent member may appoint a deputy or may vote by letter or telegram.

By clause 4 of Part I, all future borrowings are to be made by the Commonwealth, on behalf of itself or of any state, including conversions, renewals, redemptions and consolidations of the public debts of the Commonwealth and of the states.

An exception is that the Loan Council may by unanimous decision permit a state to borrow abroad in its own name, in which case the Commonwealth must guarantee that the state will perform all its obligations to bondholders, and for the purposes of the Agreement (e.g. in connection with sinking fund

contributions) the moneys so borrowed shall be deemed to be moneys borrowed by the Commonwealth on behalf of that state.

A further exception is provided by clause 5, whereby a state may borrow within its own boundaries "from authorities, bodies, funds or institutions (including Savings Banks)... and from the public by counter sales of securities," the latter only at the office of the State Treasury or other places approved by the Loan Council. No state may invite loan subscriptions by the issue of a public prospectus, except in the case of overseas borrowings authorized by the Loan Council under clause 4.

A further exception to all the foregoing rules is that any state may "borrow money for temporary purposes by way of overdraft, or fixed, special or other deposit," subject only to the "maximum limits (if any) decided upon by the Loan Council from time to time for interest, brokerage, discount and other charges," and not otherwise subject to any provision of the Agreement, i.e. such amounts may be in excess of the total borrowings authorized for the state by the Council, and are not moneys deemed to be borrowed by the Commonwealth on behalf of the state. Another part of clause 5 provides similarly with respect to "temporary borrowings" generally, which would seem to include the foregoing and also temporary borrowings not coming within the categories already mentioned. "Temporary" is nowhere defined. The whole clause is somewhat ambiguous. Apparently temporary borrowings can only be made within the state, except such as are "by way of overdraft, or fixed, special or other deposit."

In the case of all such authorized borrowings within the state, it is provided that any securities issued shall be Commonwealth securities to be provided by the Commonwealth upon terms approved by the Loan Council, and such borrowings are to be subject to the Council's limits on interest, etc. All moneys borrowed under this clause, except such as are "solely for temporary purposes", are deemed to be moneys borrowed by

the Commonwealth on behalf of the state.

Clause 5 also contains special provisions with regard to conversions. Any state may convert "securities given or issued at any time by that state for moneys previously borrowed or used in manner stated in this clause". A possible ambiguity is whether this includes analogous borrowings prior to the Agreement. New securities issued in conversion are to be Commonwealth securities, and the amount shall be deemed to be moneys borrowed by the Commonwealth on behalf of the state.

If the sum of all moneys borrowed under this clause which are deemed to be moneys borrowed by the Commonwealth on behalf of a state, and the amounts actually raised by the Commonwealth on behalf of that state, exceed the state's allotment for the year, the excess is deemed to be part of the state's allotment for the succeeding year, unless the Loan Council otherwise decides.

Clause 6 makes similar provision for Commonwealth borrowings within the Commonwealth, gives similar exemptions to borrowings for temporary purposes, and similarly requires that if all moneys borrowed under this clause other than those for temporary purposes, when added to all other borrowings duly made for the Commonwealth itself, exceed the Commonwealth's allotment for the year, the excess shall be deemed to be moneys received by the Commonwealth on account of its loan programme for the following year.

Conversions under clauses 5 and 6 are the only kind of conversion loan directly or indirectly affected by the Council's control of aggregate borrowings. In effect, this type of conversion is homologated to new borrowing. The explanation would appear to be that the provision in question brings within the limits on maximum borrowings loans for conversions of "temporary" loans, which latter were exempted from Loan Council control, but the language used indicates that loans for redeeming or renewing (as distinct from "converting") previous loans are not covered by such provisions.

The final paragraph of clause 4 explicitly forbids any borrowings by any government otherwise than in accordance with the Agreement.

By paragraph (g) of clause 3, loans for defence purposes approved by the Commonwealth Parliament are wholly exempt from the Agreement.

(6) Miscellaneous provisions

Other provisions of some importance are:

(a) By clause 1 of Part IV, each state is required to repay to the Commonwealth all expenses of the latter incurred in carrying out the Agreement, including loan flotation charges, expenses of conversions, etc., management charges, stamp duties, commissions on payment of interest, and exchange on transference of moneys.

(b) By clause 3 of Part IV each state agrees with the Commonwealth that by faithful performance of its obligations under the Agreement it will indemnify the Commonwealth against all liabilities in respect of the public debt of the state taken over by the Commonwealth and in respect of future loans.

(c) A further provision of clause 1 of Part IV is: "A certificate by the Auditor-General of the Commonwealth stating the amount to be repaid by a state to the Commonwealth and the matter in respect to which the repayment is to be made shall in the event of a dispute be conclusive as to the amount and matter stated."

(7) Effects of the Agreement.

The Financial Agreement represents not only the most far-reaching settlement of federal-state financial relations ever achieved by a federal nation, but also, in the view of those jealous of states' rights, a most radical departure from the essence of federal principles, or what was formerly regarded as such.

In presenting the Financial Agreement Bill to the House of Representatives, the Prime Minister (Mr.Bruce) noted

that the states had been apprehensive about setting up a government above governments. He did not really refute the argument that such was the effect of the Agreement, but said the states eventually recognized that the Commonwealth was "in exactly the same position as the states. They could see that we all had a common interest, and that it was our desire that the rights and privileges of the Commonwealth and the states were not in any way interfered with." He recommended the Bill to the House in the following terms:

> "I recommend the agreement to the House because it appears to me to contain a harmonious settlement of one of the most difficult questions that has existed since federation. It will mean the consolidation and the mobilization of the credit of Australia, in which direction it will be increasingly beneficial to the whole of the people. It should also insure our being able to make loan arrangements upon more favourable terms than have hitherto obtained. It makes provision for the establishment of a proper system with respect to the redemption of Australia's national debt. This parliament already has the power to make provision for the redemption of the commonwealth debt, including the war debt. The power will be extended in such a way as to cover the whole of the indebtedness of the commonwealth and the states, past, present and future. The states will be assured of a permanent arrangement under which they will have financial stability. The lack of that stability, I suggest has been one of the greatest dangers that has confronted Australia. The financial stability of the states might have been upset at any time by the ill considered action by a chance majority in this parliament."

The benefits to the states were, of course, substantial, although there was no immediate increase in assistance to current revenues -- in fact there is an increasing deficiency under what would have been received if the per capita payments had been maintained. The primary fact of the situation, however, was that the per capita payments were abolished before the new agreement was reached. In connection with subsidies, or their equivalent under the new system, the important benefit to the states is that the payments have been made a constitutional obligation of the Commonwealth until 1985 and are no longer voluntary, terminable grants. A further benefit of a different character but of equal importance consists in the de facto unification of the public debt of Australia and consequent strengthening of the credit of the states, with resulting interest savings in respect of new

borrowings, and in the facilities provided for conversion of their debt into new securities issued by the Commonwealth. The conversions which have since taken place were actually the result of the Premiers' Plan, and so far as the internal conversion was concerned depended on another financial agreement under the authority of section 105A, but the influence of the 1927 Agreement, if only by the precedent it established and the experience gained from its operation, must have been very great. The 1936 Commonwealth Year Book estimates that the total savings resulting from overseas conversions effected up to June 1936 amounted to £3,227,000 annually for the states (based on yield to maturity of the old and new issues at issue prices), and the Grants Commission estimates the annual interest savings resulting from internal conversions at £4,100,000. The combined savings to state budgets in respect of actual interest payments would be £6,696,000 as at June 30, 1936, in addition to savings of £659,000 in exchange (at 25 3/8%) on overseas interest, or a total of £7,355,000 annually.

With respect to the subsidy, several changes from the former system may be noted. The per capita subsidy, if continued, would have increased each year so long as population increased. The fixed Commonwealth contribution towards interest on states debt which replaced it has been less than the per capita subsidy would have been since the second year. Again, the subsidy used to be paid to the State Treasuries; now it is applied by the Commonwealth towards payment of interest on state debt. The sinking fund contribution is paid direct to the National Debt Commission. It is not an immediate benefit to state budgets, but will be of considerable benefit over the 58-year period as bond issues mature. (The Commonwealth contribution towards sinking fund for state debt now amounts to about £1.5 million per annum). On the other hand the necessity for definite state contributions to sinking funds imposed an additional immediate burden on four states which had not previously

been making such payments on a substantial scale, but afforded considerable relief to Western Australia and Tasmania which had been making annual sinking fund payments of 1% on most of their debt. Sinking fund contributions have, of course, been unreal during the greater part of the currency of the Agreement to date, since the states have been incurring revenue deficits during most of such period. Otherwise put, however, the states' aggregate deficits would, with the same revenues and expenditures, have been smaller by an amount in the neighbourhood of £25,000,000 for the period 1929-30 to 1936-37 if they had not had to make payments into sinking fund.

So far as the states obtained greater security under the constitutional amendment which gives legal effect to the Agreement, they also suffered a loss of independence. Whereas from 1910-27 they were in fact dependent on the Commonwealth although in law independent, they have now been legally subjected to an outside authority, the Loan Council. The states as a group can determine the policy of the Council, but an individual state might well find itself unable to follow its own desires; moreover the Commonwealth and any two states, if content to restrict their own borrowings, can compel the other four states to do likewise.

There are really two new controls established by the Financial Agreement, the control of future borrowings by the Loan Council and the control over the ultimate power of a sovereign state, that of defaulting on its debt. In connection with the latter point, the question has not been tested in the courts but it is arguable that a bondholder can compel the Commonwealth to pay interest on and perhaps also the principal of any state debt taken over, since the Agreement whereby the Commonwealth assumes liability has been declared binding by section 105A of the constitution. It is further argued by an Australian authority that the Commonwealth can be compelled to pay at the suit of any state, so that it could not sit by and permit a state to default. This argument is very strong now that the internal debts of the states have been consolidated into Commonwealth issues. At any rate,

whether it acts of its own volition or through legal compulsion, the Commonwealth has complete power to compel each state to meet interest payments and redemptions up to 1985. By section 105A the Commonwealth was empowered to make laws for the carrying out of any agreement it might make with a state with respect to that state's public debt. It was made apparent in 1932 that this includes power to interfere most drastically with the functioning of a state government which neglects or refuses or is unable to raise sufficient money, whether by borrowing, by reducing expenditures or by increased taxation, to meet its obligations to the Commonwealth. The states have now but one creditor, and the latter is clothed with powers enjoyed by none other in the world against a sovereign state.

In 1931 the government of New South Wales, of which Mr. Lang was then the Premier, defaulted on certain payments. The Commonwealth Government entered suit in the High Court in what was essentially an ordinary action for debt. (The matter apparently never came to trial but was settled about the time of adoption of the Premier's Plan by the government of New South Wales undertaking to make payment of the amount owing). In 1932, Mr. Lang informed the Loan Council that his government could not raise £500,000 out of an amount of about double that sum falling due in early February as interest on overseas debt. The Commonwealth Bank refused to lend him the money without the approval of the Loan Council; the latter refused to approve, and New South Wales defaulted. There ensued much more drastic action than in the previous year. The Commonwealth Parliament promptly passed the Financial Agreement Enforcement Act, authorizing the government to issue a proclamation directing that any specified revenues of a state owing money to the Commonwealth under the Financial Agreement should be paid to the Commonwealth instead of to the state, and that moneys standing to the credit of that state in any bank should become payable to the Commonwealth. Action was accordingly taken, and the Act

was upheld by the High Court. Federal proclamations successively stopped the state's banking facilities, directed taxpayers to pay state income tax and some other classes of revenue direct to the Commonwealth, and finally ordered state officers to pay over to the Commonwealth certain revenues coming to their hands. Mr. Lang gave orders that these proclamations should be disobeyed, and was dismissed from office by the Governor of New South Wales for refusing to govern in accordance with the law. In the ensuing elections his party was defeated, and has been defeated in two further elections since 1932. The impasse which would be created if a state government retained popular support for a policy of defiance of the Commonwealth has therefore never arisen.

For a state government in the position of that of New South Wales, it might seem that there was still one expedient that might be adopted. Unable to default on its debt charges, unable to borrow except through the Australian banks under the leadership of the Commonwealth Bank, which had become the allies of the Loan Council and the police force of the Premiers' Plan, it would still be open to such a government to resort to taxation on an unprecedented scale - or to impose a capital levy. Mr. Lang started to do so, but on the day his Mortgages Taxation Bill was presented for the Governor's assent, he was dismissed from office. On that same day the federal government had passed through both Houses of Parliament a Financial Emergency (State Legislation) Bill which, in effect, purported to forbid this capital levy unless the Commonwealth Commissioner of Taxation should certify that the payment of it would not unduly impair the taxpayer's capacity to pay Commonwealth taxation. The dismissal of Mr. Lang thus prevented a legal test of a question that is becoming important in more than one federal state. Control of competition between central and local governments in the field of taxation is not dealt with in the Financial Agreement itself.

The restrictive effect of the Financial Agreement upon state finances is not limited to the mere enforcement of a state's liability to the Commonwealth. The powers of the Loan Council were best illustrated on the occasion of the Premiers' Plan, discussed in a subsequent section. The adherence of Mr. Lang to the Plan was ensured by the necessity he was under of borrowing in order to carry on, subject as he was to a High Court action instituted by the Commonwealth in 1931 following his first tentative essay in default. The conditions of the Plan with respect to state expenditures were the only terms upon which the Council would permit further borrowing.

With regard to the control of governmental borrowing, and consequent indirect control, in periods of deficits at any rate, of revenues and expenditures, section 105A and the Financial Agreement have created a third agency of sovereignty in Australia. The Loan Council would appear to be as much a sovereign body within its sphere as the Commonwealth and states in theirs, although its composition ensures that it will act in accordance with the desires of one of two combinations of governments --five states' representatives, or the representatives of the Commonwealth and any two states, constitute an effective majority. The predominating position of the Commonwealth is evident, although in April 1931 it was by a majority decision, against the wishes of the Commonwealth, that the sub-committee was appointed whose report constituted the basis of the famous Premiers' Plan.

The creation of the Loan Council is usually regarded as the most striking feature of the Financial Agreement. The "practical unification of the finances of the Australian governments" which was so satisfactory to the banks was, in their words, achieved "through the creation of the Loan Council and the control of borrowing". Mr. Bruce's government made the establishment of such a body the price for security in payment of subsidies to the states, and in the debate in parliament on

the bill ratifying the Agreement on the part of the Commonwealth, strongly emphasized the desirability both of centralizing and of controlling governmental borrowing.

The restrictive influence of the Council was most evident during the depression. In 1927-28, 1928-29 and 1929-30 there is little evidence that the Council was responsible for such reduction in borrowing as occurred. As an instrument for securing more or less uniform performance of the obligations undertaken by all governments under the Premiers' Plan, however, the Loan Council seems to have been useful and effective, particularly as the banks refused to make any loan to governments, whether or not of the character covered by the Financial Agreement, unless the Council approved. The Financial Agreement and the powers of the Council intrude on the sovereignty of the Commonwealth as well as of the states. The Commonwealth's credit is now inextricably bound up with that of all governments as a group. It must issue its own securities for any state loan approved by the Council. The extent of its own borrowing is limited by the power of the Council by majority decision to limit total governmental borrowing in any year. The power of the Council over interest rates and other terms of loans may also interfere with the desires of the Commonwealth government. Once issued, securities are unchangeable except by permission of the Council, and now that the distinction between state and Commonwealth securities has largely disappeared with the conversion of most of the internal and external debt, the Commonwealth can probably be prevented from defaulting on its share of any bond issue, at the suit of any state.

The terms of the securities issued for the internal Conversion Loan are in fact unchangeable except by unanimous agreement of all governments or by a constitutional amendment, since the conversion was actually carried out in pursuance of a new financial agreement made under the authority of section 105A. Finally, Commonwealth payments to the states, in the

shape of contributions towards interest and sinking fund, have been made obligatory until 1985.

In one important respect, however, the Commonwealth retained a measure of freedom which was not available to the states. It was unable to borrow on a large scale except through the Loan Council, and the existence of the Agreement and of the Council assisted the banks in taking an early stand (December, 1930) against any governmental borrowings whatever unless approved by the Council. Nevertheless, if it had been unable to control the Loan Council, or if it decided on such a course as essentially preferable to borrowing, the Commonwealth could have resorted to currency inflation. The policy desired by Mr. Theodore, Commonwealth Treasurer in the Scullin Government, as the method of withstanding the depression, was in fact credit expansion, which could have been accomplished, or at any rate attempted, by currency inflation. It was the rejection in April 1931 by a hostile Senate of the Fiduciary Notes Bill, and in May of the Commonwealth Bank Amendment Bill, rather than the direct influence of the Financial Agreement itself, which forced the Commonwealth towards the adoption in June of the Premiers' Plan.

There seem to be three main defects in the Agreement, from the point of view of its objectives. All three would be evident more in periods of buoyant money markets than in time of depression. The first is that a state is permitted to borrow within its own boundaries, e.g., from savings banks, insurance companies, etc., without Loan Council approval. Secondly, there is no control over borrowing by municipalities and semi-public bodies. Since much state borrowing is for railways and other undertakings, and for the purpose of re-lending to municipalities, such bodies might be encouraged to borrow in their own name, thus exceeding the amount which the state itself could secure. Since the ratification of the Agreement New South Wales has removed railway revenues and expenditures from the

State Consolidated Revenue Fund. To set up such enterprises as independent corporations with capital stock wholly owned by the government and with government guarantee of their bonds, might be a means of circumventing the controls established by the Agreement. In 1932 the Premiers of New South Wales and Queensland urged increased borrowings for public works, but received little support from other members of the Loan Council. Premier Stevens (New South Wales) is said to have considered establishing a number of new statutory bodies to carry on state undertakings. He did not pursue this plan, but instead personally urged the mayors of municipalities and the heads of the existing statutory bodies having borrowing powers to obtain larger loans for public works, indicating that the State would guarantee debts so incurred. Such a policy could have no great effect under the conditions of that time, but early in 1930, before American overseas investment wholly ceased, several comparatively large loans of this character were effected, including loans to the City Council and Water Board in Sydney and to the City Council in Brisbane. The Report of the Royal Commission on Monetary and Banking Systems (1937), however, states that the states "have now arranged that these loans shall not be raised without Loan Council approval" (page 23).

Thirdly, a majority decision of the Loan Council can only restrict aggregate borrowing by all governments. Once such amount has been fixed, only a unanimous decision can affect the allocation among the various governments. Lacking such unanimity, the amount available to the states is divided in proportion to average net loan expenditures over the preceding five years. A thrifty state is thus apt to be penalized when the time comes that it desires to borrow on a larger scale. Profligacy is a sure guarantee of ability to borrow in the future, since the financial position and past record of a state has no bearing either on the amount it can raise or the interest rate it will have to pay.

The opinion of the Financial Agreement held by the Australian banks was expressed by the Chairman of the Commonwealth Bank in his letter of December 13, 1930, to the Chairman of the Loan Council when he spoke of "the practical unification of the finances of the Australian governments through the creation of the Loan Council and the control of borrowing," and went on to express the banks' view that under the existing circumstances all borrowings, whether or not legally subject to control by the Council, should be centralized under the Council, and that "individual applications....of any government for financial assistance can only be viewed in the light of the total requirements of all the governments."

VIII AUSTRALIAN POLICY IN THE DEPRESSION

(1) Features of the Australian economy prior to the depression

The five years preceding the depression were for Australia a period of great prosperity, the nature of which determined, in large part, both the strength and weakness of the country when the time of trial came.

This prosperity was based upon three chief factors, increasing volume of production and of exports, high export prices, and a large and fairly regular inflow of capital. The depression eliminated the third and drastically reduced the second. But for the fortunate and in part fortuitous continued increase in volume of exports it is doubtful if the country could have stood the strain, nor made a success of the Premiers' Plan and the general policy associated therewith.

During this prosperous period the annual income from abroad was approximately one-quarter of total national income, and in 1928-29 amounted to about £170,000,000, of which £140,000,000 came from exports and £30,000,000 from long-term borrowing by governments, in addition to some private capital imports. Because of the magnitude of such income, external forces were more important than internal. "Banking policy before the depression was intimately related to the balance of payments and was the passive rather than the active element of the relationship. Internal loans for public works were only half as great as external, and were financed from current saving. Deliberate policy on the part of Australia in promoting prosperity before the depression was therefore largely confined to overseas borrowing and the expansion of export production". (Copland, "Australia in the World Crisis 1929-1933", page 12)

Volume and total value of wool production in 1926 to 1928 were 30% greater than in 1921 to 1923, and wheat showed similar increases of 20%, although the acreage increase was 34%. These two products accounted for 61% of total exports. Overseas public debt increased by 36% between 1923 and 1928, interest payments increasing 44%.

The vulnerability of a country so largely dependent on world prices and on conditions in external loan markets is apparent. Other elements of danger may be mentioned. Internal costs and prices were very high, partly in reflection of high export prices, partly owing to the large governmental loan expenditures, and partly due to the ever-rising tariff. Increases in the latter led to higher costs, especially as wages were tied to a cost of living index, and increased costs resulted in further demands, which were granted, for increased tariffs. Various lines of primary production, notably sugar, butter, and dried fruit, in turn obtained subsidies and protected home markets, by means of which, and the high level of wool and wheat prices, agriculture was able, for a time, to bear the burden of secondary costs. Such costs, however, were relatively rigid, and a further element of rigidity appeared in government finance. Spurred by the great increase in imports (which in the period 1922-29 exceeded exports by £66 million, a reversal of the previous trend of the Australian merchandise balance of trade) an increase in itself due in part to government borrowing, the Commonwealth government reduced income taxes substantially and leaned heavily on swollen customs revenue, which melted away in the depression. Expenditures were increased proportionately. Likewise, based upon a 100% increase in tax revenues between 1920 and 1928, the states greatly increased their expenditures from consolidated revenue. The heavy borrowing, at higher and higher rates of interest, resulted necessarily in a sharp rise in annual debt charges, and the greatest increase was in the interest on overseas debt, the kind which it would be the most difficult to meet in time of depression.

There were, to be sure, some "revisionist tendencies," as Professor Copland has pointed out, and adjustment might have occurred if the depression had not come when it did. Nevertheless, the vulnerability was real, and contributed both to the early onset of the depression and the magnitude of the first

impact, although it might be said that this may in turn have indirectly assisted the adoption of remedial measures much earlier and more effectively than would have been the case if greater gradualness had encouraged more prolonged temporizing.

The revisionist tendencies were not very pronounced. Overseas borrowings in 1927-28 were the greatest of any year, and the virtual cessation in 1928-29 "came almost entirely from the drying up of supply". (Maclaurin, "Economic Planning in Australia 1929-1936", page 25) The last new long-term loan raised in London was in January 1929, and 84% of the amount had to be taken by the underwriters. In April the Loan Council desired to raise a further loan, but was unable. On the other hand, there were warnings from economists over the high level of nominal wages and the excessive burden imposed on export production by the tariff. By 1929 even the Tariff Board was becoming restive, but the policy of the new Scullin Government, facing evident signs of economic trouble in the autumn of that year, was to raise tariffs still further.

Nevertheless, there were elements of strength and of ability to meet a crisis when it should arise. Production had increased considerably, and "excess" capital equipment developed which, while likely to aggravate a crisis in its early stages, could nevertheless be useful in assisting a positive policy of adjustment. Substantial gold reserves and holdings of sterling exchange had been accumulated by the banks, which were later to hold the fort pending decisions on further policy. The new charter of the Commonwealth Bank was ultimately to prove useful. There was also the machinery of the Financial Agreement and the Loan Council by which state co-operation could be facilitated if the Commonwealth were determined to carry out any positive policy of readjustment with respect to government finance.

Cracks in Australia's economic structure can now be seen as early as 1927. From 1927 to 1929 export prices fell slowly, nominal wages rose, unemployment increased, and a business recession set it. Between the beginning of 1927 and the third

quarter of 1928 the percentage of unemployment among trade unionists (the only index of unemployment in Australia at this time) increased from 5.9 to 11.4. After a slight improvement, the trend was renewed in 1929.

The League of Nations' World Economic Survey for 1931-32 shows a recession for Australia beginning as early as January 1928, earlier than any other major country covered by the survey. The fiscal year 1928-29 was definitely one of mild but increasing business recession, recognized by the Prime Minister in addressing the Conference of Commonwealth and State Ministers in May 1929. No action was taken, however, and the new Labour government, elected in October, came into power just as the full force of the commodity price debacle was breaking over the country.

(2) The nature of the crisis in Australia

The crisis in Australia was of three-fold character, affecting the foreign exchange situation, government finances, and national income, with, in the latter connection, an undue proportion of the early losses falling upon export producers. The measures ultimately taken, both deliberately and by force of circumstance, tended to rectify the situation with respect to each such matter by a mixture of deflation and inflation, and through their comparatively early adoption, which was in part due to the early impact of the depression in Australia, enabled the country to take full advantage of the reversal of the world deflationary movement as soon as it occurred.

The degree of change from the days of prosperity may be briefly indicated. Based on the average of the years 1925-26 to 1928-29 as 100, the index of export prices (in Australian currency) fell to 74 in 1929-30, to 58 in 1930-31, and was 56 in 1931-32 and 1932-33. The import price index did not go below 90 until 1932-33, and never went lower than 87. In 1928-29 merchandise exports (including gold to the extent of new production) were £140 million and merchandise imports £150 million. In 1929-30 the value of exports fell by £42 million (sterling) while imports

decreased by only £11 million. The crisis in the balance of payments was acute. It began in 1928-29 with the cessation of long-term government borrowing overseas. In the two years 1928-29 and 1929-30 the combined deficit on current account in the balance of payments was £88 million, and would have been £113 million but for the large specie exports taken almost entirely from the banks' gold reserves. Near balance was achieved in 1930-31 when there was a reduction of 54% in the sterling value of imports, resulting chiefly from the lesser purchasing power of the people and exchange depreciation, and to some extent from the higher tariffs imposed in 1929-30 whose effect had been delayed through the high government expenditures and the over-valuation of the currency in 1929-30 and the first half of 1930-31. A further fall in imports of £17 million in 1931-32 while exports (through increase in volume exactly counteracting the continued fall in sterling prices) remained steady, resulted in a surplus on current account of £15 million.

The loss in national income, delayed in 1929-30 through government and bank policies which kept up imports, was estimated as 29% for 1930-31 as compared with 1928-29, and 33% in 1931-32, measured in money. The loss in real income in 1930-31, as compared with 1928-29, was 20%, improving to 18% in 1931-32; in Professor Copland's view, the loss would have been much greater in 1931-32 and subsequent years but for internal measures which, by spreading some of the loss from export to domestic producers, tended to prevent the originating loss--through collapse of export values--from doubling by retarding internal production in all lines. There was further the very fortunate increase in volume of export production, but for which the volume of imports would have had to fall still further, with consequent increase in the loss of real income. Increase of population, of course, made the loss of real income per capita somewhat greater. The incidence of the loss in the early stages was most uneven, ranging from 10% in interest and fixed payments and 12½% in

wages and salaries to 47% in entrepreneur income (the latter including all farmers), according to Professor Copland's estimate for the end of 1930, these figures being based on money income only.

The catastrophic fall in export prices has been mentioned. Between January 1929 and December 1930 the Australian index fell by 45%. There was also a rapid reduction in volume of production in protected industries, though prices were slow to respond, as were wages. Many wage-earners, however, suffered through unemployment, which reached 23% in the fourth quarter of 1930 and 28%, almost the maximum for depression, by the end of 1931. A considerable portion of the total increase in unemployment, it is clear was not due to the internal business slump but to the cessation of governmental public works.

Likewise government finance, becoming unsatisfactory before the depression, rapidly approached a crisis, which, like other matters mentioned previously, might have occurred even sooner, but in less acute form, but for the stop-gap policies of 1929-30. The maintenance of loan expenditure and imports in that year not far below the 1928-29 level kept revenues up temporarily. In both 1929-30 and 1930-31 Commonwealth expenditures from Consolidated Revenue Fund were greater than in 1928-29. In 1929-30 tax revenue increased slightly, but fell by £8 millions in 1930-31, customs and excise collections alone being less by £10 millions than the previous year. The deficit was only £1.5 millions in 1929-30, but was £10.8 millions in 1930-31. The deterioration occurred earlier and lasted longer for the states, with their large business undertakings. Despite increased revenue from taxation, the combination of continued expenditures on the former scale and drastic reduction in non-tax revenue resulted in an increase in combined state deficits from £3.0 millions in 1928-29 to £8.9 millions in 1929-30 and £15.5 millions in 1930-31. In the latter year, total Commonwealth and state deficits therefore amounted to £26,300,000 on

revenue account in addition to net loan expenditures (from internal borrowings) of £16,000,000, with the situation becoming worse each month. By January 1931 Commonwealth stock was selling at a price yielding an average effective interest rate of 7½%, as compared with 5¼% in the middle of 1929.

(3) Depression policy 1929-31

This period naturally divides into two parts, closely corresponding to the two fiscal years. The first was marked by definite policy, which had the effect of temporarily meeting the immediate crisis in the balance of payments and government finance at the expense of greater difficulties later; the second was a period of indecision, conflict and discussion, of lining up of opinions and influences out of the clash of which eventually emerged the Premiers' Plan.

The new Commonwealth Government in November 1929 was faced with rapidly rising unemployment, falling export prices, decreased government revenues and a crisis in exchange transfer. In October the Commonwealth Bank had advised the government to pass legislation empowering the Bank to take over, on behalf of the Government, the gold reserves of the Commonwealth. (At that time in addition to the Commonwealth Bank's holdings of £22 millions, the trading banks held gold reserves of £24 millions). This was done in November, and in December private export of gold was prohibited. Australia was thus off the gold standard, but maintained its currency for some time at near-parity with gold-standard currencies. This continuance of the over-valuation of the Australian currency ("over-valued" because of the high internal costs) itself contributed to maintenance of imports and prevented, in the absence of the former overseas borrowing, adjustment of the balance of payments. Mobilization and rapid liquidation of gold reserves, sterling balances and other foreign currency reserves, and rationing of exchange by the banks, enabled near-parity to be maintained for some time, but

the drain continued, there being a decrease of over £56 million in gold reserves and bank assets abroad in 1929-30.

Gold exports were, of course, only intended as a temporary measure, to hold the fort in the transition period, while the basic trend in the balance of payments was to be rectified by other policies. Feeling in financial circles favoured reductions in wages and government expenditure, as a means of easing the "transfer" problem, but this was contrary to the Scullin government policy. Another proposal was for increased tariffs with which the government entirely agreed. So far as the government had amy positive policy in 1929-30, it lay in the utilization of the tariff as a cure not only for the adverse balance of payments but also for unemployment. The Prime Minister declared in November that "there should be a return to normal prosperity in the coming year." Allied with the tariff were to be curtailment of immigration and assistance to primary industry.

The tariff was over-hauled and considerably increased in November and December, 1929, but failed to reduce imports materially. An emergency tariff schedule in April 1930 provided for the absolute prohibition of imports of certain items, the rationing of others, and an increase of 50% in existing duties for a third group. The schedule was declared to be temporary (but remained until 1932) and established only for the purpose of curtailing imports so as to rectify the trade balance. Despite these measures, however, imports in 1929-30 declined by only 7% while exports, as world prices continued to fall, declined by 30%. Unemployment increased from 13.1% in the last quarter of 1929 to 23.4% in the last quarter of 1930.

The Scullin government also attempted to give assistance to primary production, although the amount proposed would scarcely have compensated primary production as a whole for the increased costs under the new tariff, let alone corrected the internal disequilibrium resulting from the collapse of export prices. The pre-election statement of policy had emphasized

"the fullest possible protection to all industries, primary and secondary", but the direct assistance ultimately proposed seems to have been chiefly directed to easing the transfer problem by increasing production and thereby expanding volume of exports.

The chief appeal was made to the wheat farmers who were urged to increase production as a patriotic duty, and who were to receive a guaranteed price of 4s a bushel at country points (thus in effect pooling freight rates) and a compulsory wheat pool for three years, to be established by a Wheat Marketing Bill. The farmers did their part by expanding acreage 21% (increasing from 15 million acres in 1929 to 18.2 million acres in 1930) but the Wheat Marketing Bill failed in the Senate, and with it, the guaranteed price. Considerable assistance was nevertheless given the trade balance in 1930-31 since a fortunate season combined with the increased acreage resulted in a 70% increase in production, from 127 million bushels in 1929 to 214 million bushels in 1930, although the record size of the crop itself removed part of the benefit by depressing the price of Australian wheat.

The government also proposed to establish a wool pool (though without any guaranteed price) but fierce opposition from the larger graziers decided Mr. Scullin to take no action. These two failures almost completely destroyed the agricultural programme.

With respect to financial measures, the Scullin government was opposed to deflation of any sort, but on the other hand, during this year, it fully accepted the banks' contentions that exchange parity should not be interfered with, and the government was also at this time opposed to direct currency inflation. But the Treasurer, at least, recognized that some kind of internal readjustment was necessary; the particular measures he favoured were in the nature of credit expansion. To this end, two bills were introduced in April and May of 1930 designed to facilitate the making of unlimited advances to the Commonwealth and state Governments by

the Commonwealth Bank, and to increase the direct control of the government over the Bank. Both were rejected by the Senate in the autumn.

A final comment on the year 1929-30 will serve to introduce the difficulties which came to a head in 1930-31. Commonwealth government finance made a satisfactory showing in 1929-30, the deficit being only £1.5 million as against £2.4 million the previous year, but it was becoming apparent that deterioration must soon set in. The government had refused to reduce expenditures to any extent, but revenues stayed up sufficiently. The income tax, through its natural time-lag and increased rates, did not decline but increased in total collections by about 13%. Customs revenues, owing to the combination of the higher tariff and continued unintended encouragement of imports by reason of the maintenance of near-parity with sterling, also increased slightly. On the other hand, state government finances, much more quickly responsive to changing economic and business conditions, were already in bad shape, the combined deficits of all states increasing from £3.0 millions in 1928-29 to £8.9 millions in 1929-30.

In July 1930 the government presented an optimistic budget for 1930-31 envisaging only a 5% decline in customs revenue, a surplus instead of a deficit on the post office and business undertakings, and greater expenditures than the previous year, with increased taxation to balance the budget. Within a month or two it was apparent that the actual results were going to be very different, and the conflict began between the banks' desire for deflationary measures and cessation of deficit financing, and the Labour Party's resistance to every suggestion of reduced expenditures or wages, ultimately leading the latter to adopt an inflationary programme, the rejection of which by the Senate precipitated the situation from which emerged the famous Premiers' Plan.

During the year 1930-31 little was done by the Commonwealth to assist the unemployment problem (which throughout the depression was almost entirely the responsibility of the states both as regards direct relief and relief works) nor to secure internal equilibrium. Two events did occur, however, which aided in internal adjustment. In the first place, the transfer problem was becoming acute. The banks had fixed the exchange premium of sterling at 1½% in December 1929, subsequently increased to 6 1/3% in March. The latter remained the banks' carded rate until October, when it was increased to 8¾%, and remained there until January 1931, being maintained through gold exports and utilization of sterling reserves. However, no attempt was made to control current London funds received from exports, and such funds were sold in an open or "black" market at a premium which kept on increasing until it was double the bank premium. During the latter part of 1930 the banks attempted to ameliorate the situation by restricting credits to importers, but such action came late and could not reduce imports in line with exports. In view of government resistance to any large measure of deflation, currency depreciation was inevitable. In September an exchange pool was formed, through which the government was given first call on £3 millions per month for meeting external debt charges. Meanwhile the open market rate continued to rise. In January 1931 fears of currency inflation stimulated a flight of capital, and, with much lower export prices than the year before, the strain on the banks' exchange reserves became severe. In addition, the open market was depriving the banks of their very profitable business in exchange. The Bank of New South Wales took the initiative and successively raised the carded rate, followed by the other banks, until a premium of 30¼% was reached by the end of January. Australian economists and, in October 1930, the Labour caucus, had advocated such exchange depreciation as a measure of relief to agriculture, and Australian opinion now seems unanimous that

it had that effect. From the point of view of the banks, the chief effect was that the transfer problem, caused by the attempt to keep the currency up without achieving internal deflation, was solved at least temporarily.

The other measure of internal adjustment was brought about, not by the government, but by the Arbitration Court, which in fact acted against the wishes of the government. In January 1931 the Commonwealth Arbitration Court, on the express ground that the national income had fallen, and that it was necessary to maintain industrial production and adjust industrial conditions in some degree to those of agriculture, declared that a reduction of 10% in the basic wage must be put into effect immediately. The Court proceeded to apply the cut to almost all industries under its jurisdiction, affecting about 400,000 workers. State Arbitration Courts eventually followed suit.

Meanwhile government finances were going from bad to worse. At the Premiers' Conference at Melbourne in August it had been agreed to balance both Commonwealth and state budgets for 1930-31 and subsequent years, but this proved impossible with the unforeseen catastrophic fall in revenues and the Labour Party's refusal to permit reduction of expenditures. The Australian Council of Trade Unions called upon the governments to repudiate the Melbourne Agreement and to dissolve the Loan Council. In October the Federal Labour caucus passed a resolution that the Commonwealth Bank should be required to create sufficient credit to finance the budgetary needs of the Commonwealth government and in addition £20 millions for loan works. The leading members of the Scullin government were desirous of effecting substantial economies, but majority opinion in the caucus was adamant.

Obviously, the only ways out were repudiation or inflation, and Labour Party opinion tended more and more strongly towards the latter, with occasional suggestions of repudiation which served only to frighten the country. On the other hand, the banks began to resist any extension of such inflation as had

already taken place. Advances by the banks to the various governments, plus treasury bills, had risen from £5.5 million in June 1929 to £53.0 million in December 1930; this was mostly overseas floating debt (£38 million by September 1930) which could not be funded. The banks on the one hand restricted loans to other customers thus limiting the inflationary effect of governmental bank borrowings, and also put a potential check on government borrowings (December 1930) by requiring approval of the Loan Council in every case, whether or not the particular loan desired came under the legal jurisdiction of the Council. Further the depreciation of the currency in January 1931, while tending to increase national money income, had the immediate effect of imposing a further burden on government finances. From now on the "battle of the plans" really got under way. For some months the Australian economists, who are comparatively few in number, highly respected and who exhibited a marked capacity for agreement on principles, had been urging the Government to adopt a positive policy of internal adjustment, and by their public pronouncements provided a point around which discussion by politicians and the public might revolve. There seems little doubt that the central theme of most of these politico-economists, equal sharing of the loss of the national income, played an important part both in the formulation of the Premiers' Plan and in its acceptance by the people.

In the first "Economists' Manifesto" of June 1930, restoration of equilibrium through spreading the loss of income, and freeing foreign exchange, were stressed. In September 1930 a comprehensive "Plan for Economic Readjustment" was submitted to the Commonwealth Treasurer by Professors Giblin and Copland and Mr. E. C. Dyason, who suggested restoration of internal equilibrium by a 10% reduction in real wages, increased income tax, depreciation of exchange by at least 20%, expansion of bank credit, direction of Commonwealth Bank policy towards maintenance of stable prices, and purchase of government securities and

increase of note issue by the Commonwealth Bank so far as necessary to sustain the cash reserves of the trading banks and maintain "the general level of prices."

In January 1931 the second Economists' Manifesto was published, repeating the provisions of the first and advocating a 10% reduction in real wages, reduction of interest rates and of public expenditures, and allowing foreign exchange to go to "the natural price."

At the Premiers' Conference in February three plans were proposed. A Committee of the Loan Council, consisting of the Chairman of the Commonwealth Bank Board, the Assistant Secretary to the Commonwealth Treasury and five state Under-Treasurers, assisted by three economists, proposed that budgets should be balanced by drastic reduction in government expenditures, a plan which met with a frigid reception from the Commonwealth government. The second plan was proposed by Mr. Theodore, the Commonwealth Treasurer, and might be called a "reflationary" programme, combined with all feasible governmental economy. The objectives were expressed to be reabsorption in industry of the unemployed, restoration of budget equilibrium, maintenance of national solvency and an equitable spread of the loss of income over all sections of the community. The programme included reversal of the policy of restricting bank credit with a view to raising prices to the level of the 1925-29 average, extensive purchasing of government securities on the open market by the Commonwealth Bank so as to bring the yield on government bonds down to 5% (as compared with the existing yield to maturity of between 7 and 7½%) raising a loan to finance farm relief measures and public works, substantial reduction in rates of interest on deposits and overdrafts, permitting the exchange to go to its natural level, special taxation of income from government bonds, and "rigid economy in state and Commonwealth expenditure." As explained to the Conference and to Parliament, a substantial rise in prices was regarded as essential. The plan was agreed

to by the conference, except for Mr. Lang, the Premier of New South Wales. It was not favourably received by the banks. Their reply to Mr. Theodore stated they would be willing to consider the question of co-operation with the government in the programme to stimulate the revival of industry after the government had carried out drastic economies.

Meanwhile Mr. Lang at the Conference denounced the Theodore plan as entirely dependent on the co-operation of the banks, and presented a hastily prepared plan of his own, which merits some consideration as it is arguable that but for Mr. Lang's extremism (in which he was consistently supported by the New South Wales Labour Party), the course of conduct he followed and the fear he inspired, effective co-operation of all elements in agreeing to and carrying out the Premiers' Plan might never have been achieved. At this time he proposed reduction of interest on all government bonds in Australia to 3%, and that no further interest be paid on overseas debt until Britain dealt with it on the same basis on which she settled her own debt to the United States (as later explained, this meant reducing the rate on London loans to 3%), and substitution of a "goods standard" based upon the wealth of Australia in place of the gold standard. The last point is meaningless, but by emphasizing the need for reduction in debt charges, and indicating that governments might repudiate, he may have assisted in the ultimate success of the most important element of the Premiers' Plan, conversion of public debt, as an alternative to repudiation or inflation. Certainly, for the time Mr. Lang seriously injured Australian credit. The Conference rejected his plan, but he attempted, with the full support of the New South Wales Labour Party, to carry it out in his own state. A bill was introduced in New South Wales (but shelved by the Legislative Council) to reduce interest on government debt to 3% and to limit bank rates. On April 1, 1931, New South Wales defaulted on overseas interest payments, and though the

Commonwealth government made good the payment, a near-panic resulted from the Lang programme. There was a flight of capital to other states. A run on the State Savings Bank forced it to suspend operations. Following this, there was a run on the Commonwealth Savings Bank, which was stopped by a declaration by the Chairman, Sir Robert Gibson, in a radio broadcast, that the Commonwealth Bank would use its powers to issue notes to the full extent necessary to meet withdrawals.

Mr. Lang's actions split the Labour Party. Moderate labour opinion and the majority of the federal government bitterly opposed his programme. In March the federal executive expelled the New South Wales State Executive from the Australian Labour Party. A New South Wales Labour group in the federal Parliament was thereupon formed. In addition, six conservative federal labour members went over to the opposition, including Mr. Lyons who subsequently became leader of the United Australian Party, consisting of the former Nationalist Party and the Labour converts.

Meanwhile, even before the February Conference ended, the opposition of the banks and of the Commonwealth Bank to credit expansion produced a change in the Theodore plan, upon which the Conference divided on party lines. Sir Robert Gibson had stated that the Commonwealth Bank could not extend credit of £18 million to the government for public works and relief to wheat growers, because the export of gold had reduced the gold backing of the note issue almost to the legal minimum, and a sudden increase of government expenditure of such magnitude would cause a demand for more notes. Mr. Theodore then proposed, and subsequently introduced a bill, to create an issue of fiduciary currency limited to £18 million. Two other bills were also proposed, one, which was later dropped, empowering the Treasurer to control interest rates to be paid and charged by the trading banks, the other, The Commonwealth Bank Bill, removing the gold reserve requirement, limiting note issue by

law,and enabling the government to ship abroad the £15.6 million of gold still held by the Commonwealth Bank.

The Fiduciary Notes Bill provided for the issue of such notes only if the Commonwealth Bank refused to grant the £18 million credit. In April Sir Robert Gibson wrote to the Treasurer that the drift in government finance must be stopped, and that the total accommodation in Australia and London extended to the various governments by the Bank, which then amounted to £44.3 million, would not be permitted to go beyond £50 million, a figure which it appeared would be reached by the end of June. The Senate rejected both the Fiduciary Notes Bill and the Commonwealth Bank Bill, and an impasse was created, with the Opposition demanding a general election, and the government threatening to resubmit the Fiduciary Notes Bill and, if it were rejected again, to ask for a double dissolution. Much talk was heard of the issue of the people versus the banks, but the government found little public support for, indeed little understanding of, its fiduciary notes programme. As can now be seen, looking back, the situation was ripe for compromise.

The impetus came from the Loan Council acting (like the Arbitration Court in January) against the wishes of the Commonwealth government, which was still debating what to do. At a meeting on April 25 the Council recognized the realities of the situation and abandoned its former stand in favour of immediate balancing of budgets, but declared that the aim must be to balance the budgets by the year 1933-34. By a majority vote a committee was appointed "to report to a full meeting of the Council not later than the third week in May what further action must be taken." The Committee appointed a sub-committee of four economists (Professors Copland, Giblin, Melville and Shann), to which were subsequently added five Under-Treasurers. Their report was submitted to a special Conference of the Prime Minister and State Premiers and, on its adoption, with one or two changes, as a programme of action, constituted the Premiers' Plan.

(4) The Premiers' Plan

The Premiers' Plan of Reconstruction, adopted on June 10, 1931, was by no means a complete blueprint of economic adjustment, but was concerned primarily with government finance. Measures proposed, however, involved a degree of sharing the burdens of the depression--both the measures relating to government finance and the only non-governmental project, the reduction of interest rates generally. The plan also envisaged "the maintenance of a free external exchange rate" as a stimulus to recovery and a direct benefit to stability by the resulting maintenance of export values. Restoration of confidence was expected to result from the great reductions to be made in government deficits.

On the side of public finance the situation was indeed alarming, and it was upon this problem that the Committee and the Conference concentrated their attention, with expansionist policy postponed until budgets could be stabilized. The combined deficit of all governments was estimated at £31 million for 1930-31, and £39 million in 1931-32 and even greater amounts in subsequent years, unless action were taken to reverse the trend. It was estimated that total expenditure (other than loan expenditure) of the Commonwealth and state governments was 29% of national income in 1928-29 and would be 41% in 1931-32. A frontal attack on expenditures was obviously required, if equilibrium were to be approached by governmental, as opposed to monetary, action. The Committee took as the standard in this respect, the 20% reduction in the federal basic wage accomplished by the combined operation of the 10% special reduction under the Commonwealth Arbitration Court's awards in January and February and the automatic reductions accompanying falling prices under the Australian sliding-scale system. (In relation to purchasing power in 1931, the reduction in real income was only 10%). The recommendation was that all adjustable expenditures should be reduced on the average to 77% of the level of 1929-30, including reduction of wages and salaries to 80%. In the

preliminary budget estimates for 1931-32, adjustable expenditures were already down to 87% of those in 1929-30, so that the further reduction required would be 10%, or about £13 million. It should be emphasized, however, that much of the reduction already achieved had come as a result of lessened business activity, for example reductions in railways expenditures, and that the real effort, notably salary and wage reductions, had yet to be made. (In Western Australia and South Australia the estimates for 1931-32 already showed reductions of 20% as compared with 1929-30). No reduction was contemplated in the expenditure on unemployment relief, which was estimated by the State Treasuries at £10,500,000 for 1931-32, but which the Committee felt might require as much as £3,000,000 more than the estimate. (Actual expenditure from revenue for this purpose appears to have been £10,884,000 in 1931-32, compared with £8,352,000 in 1930-31).

On the revenue side, it was held that the limits of taxation had been almost reached in most states, and also for the Commonwealth with respect to direct taxes. It was recommended that Victoria and Western Australia should come up to the average severity of taxation by increased income tax, the increased revenue being £2.2 million, and that a further £2,000,000 might be possible through increased federal direct taxes. The chief increase in revenue was to come from the Commonwealth sales tax (to be raised from 2½% to 6%) and primage duty on imports (to be raised from 4% to 10%), calculated to yield an additional £8 million. These were proposed on the express ground that they fell "on everyone's consumption without directly increasing the cost of production to any considerable extent". To avoid passing on the burden largely to export industry, such increases were not to apply to basic foods, and thus would not be greatly reflected in higher wages through the cost-of-living index, nor, therefore, in higher prices for the products of secondary industry so far as such prices depended on wages.

These measures still left a probable deficit for 1931-32 of not less than £14 million, and it was at this point that the Committee took up the matter of reduction of interest on the public debt, which they recommended on four grounds: the danger

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of default or alternatively of currency inflation if deficits were not further reduced, the important practical fact that "the sacrifices asked from wages, salaries and pensions are so great that they would not be accepted if any other income-element escaped," and finally, the equitable principle of equality of sacrifice. For holders of fixed money-claims to make their contribution, conversion was the best method. Raising the price level by the issue of currency or expansion of bank credit was rejected because "under present conditions such a policy would destroy confidence in the currency". Increased taxation of income from property was likewise not favoured, for it would not aid in lowering interest rates generally, and the Committee felt that in order not only to assist public finances but to cause a general sacrifice by all creditors and have it benefit debtors generally, the method adopted should be conversion of internal public debt, "accompanied by a simultaneous reduction of bank interest rates and mortgage rates". No specific recommendation was made, however, as it was recognized that the urgency of the budget situation might make necessary a temporary recourse to the alternative of special taxation. Conversion on the basis of a 15% reduction in interest, it was estimated, would effect a net saving of £3 million; continuance of the existing 7½% special tax (Commonwealth) on income from property (including bonds) was assumed.

Based on the foregoing estimates, including conversion, the deficit in 1931-32 would be reduced to £11 millions, or £13 millions if the Committee's fear of a further decline in revenue were realized, and without considering the quite possible increase in unemployment relief of as much as £3 million. It was confidently anticipated that deficits would substantially decrease in subsequent years, and it was therefore concluded: "Because of its temporary nature and of the severity of the measures that will have been necessary to bring the deficit down to £11,000,000, borrowing to bridge the remaining gap is both

justifiable and practicable." It was suggested that the Commonwealth should give the states part of the benefit of its more favoured position under the plan, by special grants of such size as to leave Commonwealth and states with equal proportional deficits, except Victoria which it was expected would show a slight surplus, and New South Wales which should make greater economies.

The Committee had little to say on general economic policy, beyond such as has been already mentioned, except to deprecate any premature return to the old parity of exchange with sterling, which "would intensify the crisis in Australia by reducing export values once more".

The Report of the Premiers' Conference was based largely on the recommendations of the Copland Committee. The suggestion of equalization of Commonwealth and state deficits was not carried out, but conversion was decided upon on the basis of a direct reduction of interest payments by 22½% and issue of new securities free from the Commonwealth 7½% tax, a change which was equivalent to handing over to the states the amount of such tax on their own securities. The conversion proposal was as much disliked by a section of the financial and business community as was the cut in wages by a section of labour, and it is evident that only by the conjuncture of the two measures was agreement secured, after considerable difficulty. The plan was essentially a compromise which as events proved coincided with the interests of the country as a whole, having regard to all the factors in the situation which had to be met. It contained no practical elements of general economic policy but was directed primarily towards solution of a crisis in governmental finance, a crisis which no single force in the country was in a position to resolve alone. Nevertheless, when viewed by itself and with due regard for its limited sphere, it appears as a most striking illustration of deliberate acceptance of direct sacrifices by a democratic country.

The forces opposed to one or other of the two main features of the plan were strong; but it was clear the plan must depend for its success on widespread support, among all political parties, labour, finance, and the general public. When the Conference was discussing conversion by compulsion, the leader (Hon. J. A. Lyons, formerly acting Treasurer in the Scullin Government) and deputy-leader of the Opposition in the federal House wrote to each Premier declaring that this was a radical departure from the patriotic appeal intended by the Copland Committee. This might have broken up the Conference, for labour was hostile to wage reductions and skeptical that interest reduction would be carried out voluntarily, but by the time the communication was received opinion in the Conference was moving toward the method upon which agreement was finally reached, namely, to launch the conversion loan as a voluntary measure, but with the definite understanding on everyone's part that, in Mr. Theodore's words to Mr. Lang, "if people do not convert, they cannot be allowed to go free of making a contribution to the national sacrifice". Mr. Lang eventually agreed, although stipulating that he would not reduce expenditures in New South Wales until conversion was an accomplished fact. The Plan was adopted unanimously by the seven Premiers and the leader and deputy leader of the Opposition in the federal Parliament. State Opposition Leaders then held a Conference and likewise gave support to the plan as regards reduction of interest and expenditures, although expressing regret that governmental finance was the only problem dealt with.

Support from sources outside the political parties was needed, however, for the success of the Plan, and assurance thereof was required before the Plan was adopted. The banks declined to underwrite the conversion, but agreed to reduce interest rates on overdrafts and on fixed deposits. Banks, insurance companies and other large holders of securities, whose aggregate holdings of internal government bonds amounted to at

least 40% of the total, agreed to the conversion in advance. The Leader of the Opposition agreed to act on the National Appeal Executive, whose other members were the Prime Minister and the Chairman of the Commonwealth Bank, to direct the conversion campaign.

The items of the Plan as finally adopted, which was declared to be an indivisible whole with the carrying out of each part dependent upon the carrying out of all parts, and which each of the governments bound themselves to carry out, were as follows:

(a) Reductions averaging 20% in all adjustable government expenditure as compared with the year ending June 30,1930.

(b) Conversion of the internal debts of the governments on the basis of a 22½% reduction of interest.

(c) Increased taxation of at least £1.5 millions by Commonwealth income tax and £6.4 millions by sales tax and primage duty. (The increased State taxation recommended by the Committee was not included in the formal Plan)

(d) Reduction of bank and savings bank rates of interest on deposits and advances.

(e) Relief in respect of private mortgages, by legislation.

The Premiers' Plan and its execution represents the success of the Australian people in performing one of the most difficult tasks to be attempted in a country democratic in political structure, and a network of rigidities in economic structure, that of attempting, achieving and enduring widespread deflation by open and concerted action based upon popular consent. That it would have been sufficiently heroic a measure for the needs of the situation but for certain extraneous aids, discussed below, may well be doubted. That it was, in itself, a "middle course between inflation and deflation", a "judicious mixture" of both, as Prof. Copland suggests, or that it was in any measure a programme of general economic policy, is even more dubious.

It is nevertheless true that the economists, exhibiting a marked degree of agreement, did advocate a fairly comprehensive programme of economic adjustment, and that partly by accident or force of circumstance and only partly by deliberate policy, events in Australia did shape themselves roughly in conformity to a large part of such programme. Thus the Memorandum of Professors Giblin and Copland and Mr. Dyason in September 1930, and other pronouncements of economists both before and after the adoption of the Premiers' Plan, favoured a free exchange with a view to stopping the fall in national money income and spreading the loss in export values over the whole community. The Commonwealth Bank and the trading banks supported the exchange rate, and depreciation did not take place until gold and sterling reserves were nearing exhaustion. The economists desired not only depreciation, but in their later pronouncements a free exchange. The banks, however, maintained a fixed rate from January to December 1931 and another (under direct management by the Commonwealth Bank) from December 1931 to date--fixed, that is, by reference to sterling. By reference to gold, the abandonment of the gold standard by Great Britain resulted in the Australian pound fluctuating in exactly the same degree as sterling. The economists had had the definite objectives of maintaining national money income and assisting export production. Such changes in exchange rates as occurred were merely the result of superior force acting against the desire of the authorities for stability at as close to sterling parity as possible.

Again, behind the protection of a depreciated currency the economists advocated internal inflation, or at least measures to prevent the price level from continuing to fall. The Memorandum mentioned above proposed "an expansionist monetary policy based upon the purchase of government securities by the Commonwealth Bank with a view to maintaining the general level of prices as measured by the complete retail index number". Considered by itself, this would be in conflict with the "central problem" of

redistributing the loss in national income, but it was regarded as necessary for business recovery, and it was intended to accompany a restoration of exporters' real income to 90% of the former level by exchange depreciation; together these measures were to bring about "stabilization". However, there was no mention of the matter in the Premiers' Plan, and at no time was such a policy pursued. The only expansion of bank credit through purchase of government securities that occurred, came not through open market operations, nor as a matter of monetary policy, but from the issue of treasury bills to meet the deficits that still existed under the Premiers' Plan. This was not done as a matter of deliberate policy but simply because public loans could not be floated. It was contrary to the recommendation of the Copland Committee, which thought borrowings to meet government deficits "should come from current savings rather than from new bank credits".

Finally, it is interesting to note that one of the steps most emphasized by the 1930 Memorandum, reduction of real wages by 10%, came about, in the first instance, not as part of a general plan, and not by governmental action, but by independent action of an autonomous body, the Commonwealth Arbitration Court. It should be mentioned, however, that the economists had intended such a development; and that the Court was influenced in its decision by the general trend of economic thought, as expressed by Professor Copland, who appeared before it, and that it openly gave as one of the grounds for wage reductions that the loss in national income had chiefly fallen on export industry and should be more widely distributed.

(5) Implementation of the Premiers' Plan and other aspects of Australian recovery

(a) Reduction of interest rates

(i) Conversion of public debt

The internal conversion loan in July and August 1931 was a great success. A vigorous campaign of propaganda was launched, with all political parties participating. "Equality of sacrifice" was advanced and accepted as a patriotic duty and, subject to

bitter opposition from die-hards in both camps, was the basis of the acceptance of reduction in income by wage-earners and bond-holders. That observers were correct in ascribing the greatest importance to the psychological factor is indicated by the fact that express notification of assent to conversion was given by holders of 91% of the outstanding internal debt of £558,000,000, although such express assent was not technically necessary since the scheme provided that conversion would be automatic except in case of express dissent. Dissent was registered with respect to only 3% of the debt.

The manner of effecting the conversion is an interesting example of the new machinery in Australia for joint action by Commonwealth and states in the financial field. An Agreement was entered into between all governments, under sec. 105A of the constitution, in the same way as the Financial Agreement of 1927. Each parliament passed a Debt Conversion Agreement Act ratifying the Agreement, and the Commonwealth parliament then passed an Act for the conversion loan. All parliaments passed acts empowering trustees to convert their holdings of the public debt into the new loan. Subsequently all parliaments passed acts for the compulsory conversion of the holdings of the dissident 3%, amounting to £17.5 million.

The average rate of interest on the internal public debt of all government combined was 5.27% at June 30, 1930. Conversion was designed to reduce this by 22½%, i.e. to an average rate of 4.08%. The gross savings in interest were about £6.5 million per annum, but this is subject to two qualifications as regards the effect on budgets: first, part of the states' debt had been incurred in order to make loans to settlers and local public bodies, and on conversion the benefit of the reduction was passed on to such debtors, the annual amount of such reduction being approximately £1 million; secondly, in 1930-31 the Commonwealth had imposed a special tax of 7½% on income from property, to be applied in 1931-32, but the conversion loan was exempted

from such tax.

Commencing in 1932-33 large further savings were obtained through conversion in London of sterling loans maturing or carrying a right of redemption. In 1932-33 the need of meeting such maturing obligations led to the appointment of a resident Minister in London, who arranged for the conversions in conjunction with the Australian Loan Council. Evidence of the striking recovery in Australia's credit position may be seen from the fact that in 1932-33 nine state issues aggregating £51 millions were converted into new Commonwealth securities, with average rate of interest reduced from about 5¾% to less than 4%. Between October 1932 and June 1936 almost £200 millions of Commonwealth and state overseas debt was converted, with resulting total annual savings (based on yield to maturity) of about £4.1 millions, inclusive of the 25% exchange premium. As a result of the Financial Agreement and the Commonwealth guarantee, all states were treated alike, irrespective of what their previous credit position might have been. The average nominal interest rate was reduced from 5.05% to 3.42%; the yield to maturity, having regard to issue prices, was reduced from an average of 5.25% per annum to 3.57%.

(ii) Relief of debtors

The Premiers' Plan required that relief should be provided for private mortgagors, and legislation was passed in all states, though with many variations in detail, reducing fixed money incomes by 22½%. The standard basis for all acts was reduction of interest on mortgages, defined as "any deed or agreement whereby security for repayment of money is granted over any real or personal property or any interest therein", a definition which was interpreted to include corporation debentures but not municipal bonds. In three states, municipal bonds were included under a special clause; in the others, municipalities had to apply to the state for relief. New South Wales went much farther than other states, by legislating

generally with respect to "the obligation to pay interest," and, alone of the states, abolished the personal convenants in mortgages and reduced dividends on preference shares by 22½%.

As to the manner of effecting the adjustment, in four states the reduction was automatic on the passing of the legislation, subject to a discretion given to the Courts, (for the most part unrestricted) upon application by a creditor, to modify the reduction, in favour of that creditor. In 1932 the Full Court of Victoria refused to interfere in favour of a bondholder of a company with large reserves which under the new legislation was paying only 5% on its debentures and was paying average dividends to shareholders of over 6%. In the other two states (Queensland and South Australia) the reduction was not automatic, but was to be granted by the courts upon application of a debtor who could show special circumstances, the determination of the latter being left almost wholly to the Court's discretion.

Besides interest reduction there was also moratorium legislation. Each state passed a Moratorium Act of general application, either prohibiting creditors from exercising their remedies without special leave of the court, or enabling debtors to get a court order restricting creditors, particularly mortgagees, from taking proceedings. There were also Debt Adjustment Acts for the relief of farmers, discussed below in connection with assistance to agriculture.

The duration of the interest reductions varied; most of the acts were of short duration, but were renewed, so that all were still in operation in September 1936.

Victoria and New South Wales also passed acts reducing rents by 22½%.

The Premiers' Conference of June 1931 had decided to permit banks to reduce overdraft and deposit rates voluntarily, the banks having agreed to do so by reducing rates on the average by 1%. New South Wales, however, proceeded to legislate

an automatic reduction of 22½%, and three other states provided that if rates on advances were not brought down by October 1, they were to be reduced by proclamation. This did not prove necessary. McLaurin ("Economic Planning in Australia" (1936) p.90) states that one of the banks attempted to force its customers to close out old accounts and open new ones at the former rate of interest, but public opinion brought it into line. The Wallace Bruce Committee reported in April 1932 that the banks had reduced interest on overdrafts by an average of about 14%, and further reductions with respect to both deposits and advances were made subsequently.

The widespread interference with the contract rights of creditors, in respect of both governmental and private debt, does not seem to have had serious ill effects on the psychology of investors or the solvency of financial institutions. A small but vocal group loudly condemned the conversion operation in 1931, but conversion, in conjunction with the other elements of the Premiers' Plan, apparently restored public confidence in governmental finance. The patriotic character of the enthusiastic reception of conversion by the general public has been mentioned. People believed that reduction in their income from government bonds was not only a necessary sacrifice but a means of safeguarding and in fact restoring their principal. The Plan also allayed fears of inflation. As a result, the average yield to maturity of Commonwealth securities in Australia at current market prices, which had been 5.25% at the end of June 1929 and reached 7.70% in March 1931 and 13% on June 4, 1931, receded to 6.20% at the end of September 1931 and 4.10% a year later. The decline continued until 1934, being 3.20% at the end of September in that year, after which the average rose to about 4% at the beginning of 1937. Municipal bond yields followed a similar trend. Less than one per cent of municipal debt went into default during the depression, the interest relief afforded in pursuance of the Plan being of considerable

importance in enabling municipalities to pull through a difficult period.

The effect of the general and "artificial" reduction in interest rates, both on government bonds and private debt, on the financial institutions is difficult to gauge. Banks, of course, were able to reduce interest on deposits in proportion to the reduction in interest on advances and investments. Total profits of trading banks, which were uniformly close to £5 million in each of the four years 1926-29, were £4.4 million in 1930, £3.0 million in 1931, went to a low point of £1.9 million in 1932, and showed little improvement in the next four years. Their preference share dividend remained at 4% from 1928 to 1936; ordinary share dividends averaged from 11 to 12 per cent during 1926-30, declined sharply in 1931, and again in 1932 to about 5%, where they remained until 1936. Reserves declined £1,000,000 in 1931 and had not been increased by 1936. The suddenness in the decline in gross income in 1931 and 1932 is no doubt attributable to the interest reductions resulting from the Premiers' Plan, mostly voluntary reduction of the interest charged on advances since the trading banks held only small amounts of government and other securities; but since interest on deposits declined sooner than, and to at least as great an extent as interest on advances, it would seem that the fall in profits was due to business stagnation rather than mere interest changes.

Life insurance companies were directly affected by the internal public debt conversion and the legislation reducing interest rates on private debt (individual, corporation and municipal). Their income from investments was 20% lower in 1932 than in 1930; having regard to the increase in total investments the decline in investment income was of the order of 25%. The insurance business as such seems to have weathered the depression very well. Total business in force ("ordinary" and "industrial" life insurance) reached a peak in 1930, declined 3% in 1931, and thereafter increased steadily.

Exact figures are not available as to the various holdings of internal public debt in 1931; banks of all kinds (including all departments of the Commonwealth Bank) held some £166 million, or about 30% of the outstanding debt of £558 million; insurance companies held at least £95 million of "government and municipal securities" in Australia; it would thus seem probable that the institutions mentioned held from 40 to 45 per cent of the outstanding government internal debt. A more complete analysis of holdings at June 30, 1936, has been published in the Report of the Royal Commission on Monetary and Banking Systems. Holdings of long-term securities maturing in Australia are shown on page 16 and of treasury bills on page 379 as follows:

	Long-term securities	Treasury bills
	£000,000	
Commonwealth Bank (including general banking, note issue, and rural credits departments, and the Commonwealth Savings Bank)	111.3	23.5
Other savings banks	42.8	
Trading banks	20.3	23.2
Insurance companies	62.0	
Trust companies (mainly trust funds)	38.3	
Superannuation funds	15.0	
Governmental trust funds and semi-governmental authorities	20.3	
	310.0	46.7
Other institutions and general public	277.1	
	587.1	
Not stated	25.1	0.3
Total outstanding	612.2	47.0

(b) Restoration of budget equilibrium

Prior to the adoption of the Premiers' Plan, it was estimated by Treasury officers and the Copland Committee that combined deficits for 1931-32 would be from £39 to £41 million, without the special 7½% tax on income from property. Under the Plan, as revised at a Premiers' Conference in September 1931, the estimate was £13 million. The realized deficits of the states were £20.8 million, New South Wales alone exceeding its quota by £8 million ; the Commonwealth had a surplus of £1.3 million, so

that the combined deficit was £19.5 million.

At a Premiers' Conference in June 1932 it was evident that current deficits would aggregate about £20 million. It was agreed to continue the Premiers' Plan in full force, and by the application of the planned economies for a full year it was estimated that for 1932-33 the states would have aggregate deficits of £9 million and the Commonwealth would balance its budget; this objective was more than attained, the states' deficits being £8.0 million, and the Commonwealth showing a surplus of £3.5 million despite concessions in taxation amounting to £1 million and increased expenditure for relief to farmers of £2.25 million. Moreover, included in aggregate expenditures from consolidated revenue of all governments were sinking fund payments (including the Commonwealth contribution towards sinking fund for state debt under the Financial Agreement) to a total of £7 million.

It was evident that government finance had been restored to health, and at the 1933 Conference it was deliberately decided to continue the deficits pending a rise in export prices, upon the recovery of which had been predicated the original objective of achieving balanced budgets by 1933-34. Instead of using the probable Commonwealth surplus to balance state budgets, the Commonwealth government held that some relief should be given to industry through reductions in taxation, and that the states could successfully continue (through the issue of Commonwealth treasury bills to the amount agreed to by the Commonwealth Bank) with deficits of the size estimated until a rise in export prices and in national income should automatically raise their revenues. Tasmania, South Australia and Western Australia, however, received added assistance throughout the depression through considerable increases in their special grants. There were also in late years several Commonwealth payments to all states out of surpluses realized despite tax reductions; distributions were £2 million in 1934-35, £0.5 million in 1935-36, and a similar amount in 1936-37).

The progress of deficits from 1929-30 is set forth below. In later years there have been considerable tax reductions by a number of states, as well as by the Commonwealth. In the case of the latter, it is estimated that tax revenues in 1934-35 were £10 million less than what would have been received at

1932-33 rates. The large payments into sinking fund should also be borne in mind.

Surpluses and Deficits, 1929-30 to 1935-36
(excluding expenditures from loan funds)

£ 000,000

	1929 -30	1930 -31	1931 -32	1932 -33	1933 -34	1934 -35	1935 -36	1936 -37
mmonwealth	- 1.5	-10.8	+ 1.3	+ 3.5	+ 1.3	+ 0.7	+ 3.6	+ 1.3
ates	- 8.9	-15.5	-20.8	- 8.0	- 7.0	- 3.3	- 2.5	- 0.4
gether	-10.4	-26.3	-19.5	- 4.5	- 5.7	- 2.6	+ 1.1	+ 0.9

In this achievement of budget equilibrium the debt conversion, increased taxation and reduced expenditures provided in the original Premiers' Plan have already been mentioned. There were difficult times in 1931-32 in carrying out the Plan. The Premier of New South Wales did not conform to the Plan, and through repudiation of debt charges and defiance of the constitution was dismissed from office in May 1932. In the ensuing election his Labour party was defeated. Meanwhile, the federal Labour Party had been split, and despite its loyalty to the Plan the government was defeated in the general election in November 1931 -- an election resulting from a defeat in Parliament when the Lang faction voted against the government on a motion of want of confidence. The new government was equally pledged to the Premiers' Plan but refused to adopt any economic or monetary policy. It was announced that no tariff changes would be made except on the recommendation of the tariff board, that the determination of the exchange rate and monetary policy would be left entirely to the Commonwealth Bank, and that public works would be limited.

In South Australia the State Labour Executive expelled Premier Hill and all members who supported the Premiers' Plan from the party - but the number was sufficiently large for the government to carry on. In Victoria, the third state with a Labour government at the time of the Plan, Premier Hogan rallied

sufficient support to put through the initial reductions, but was expelled from the party in 1932 when the latter balked at some further proposals for salary cuts. In the ensuing elections Labour was defeated. On the other hand, elections in Queensland in June 1932 put Labour into power, and the full reductions called for under the Plan were not made in that state, which was never as seriously affected by the depression as the others.

During this period there was always a majority in the Loan Council favourable to the Plan, and the Commonwealth Bank continually brought pressure to bear to limit deficits and borrowings. It was necessary on several occasions for budgets to be revised, particularly in 1932, during which year there were several Premiers' Conferences - in January, April, June and October.

This great effort at budget adjustment affected both revenues and expenditures. For the states, the largest items in consolidated revenues are taxation and railway receipts. The latter fell by about £8 million in 1930-31 as compared with 1929-30 and remained at about the same level during the next three years. Increased rates of taxation in 1930-31 resulted in a slight increase in receipts over 1929-30. In 1931-32, however, despite further increases total receipts fell by £3 million, ordinary income tax alone declining by £5 million in that year. Wage taxes and special income taxes were imposed, usually under the name "unemployment relief tax", which by 1932-33 were bringing in £11 millions, and total tax revenues in that year were over £2 million greater than in 1929-30. Other state revenues did not vary greatly.

On the side of expenditures, the need for reductions was aggravated by the exchange premium on overseas interest payments. Public debt charges rose by £4.7 million in 1930-31 and a further £5.2 million in 1931-32. In the following year the conversion of internal debt was responsible for a net reduction of £4.4 million, and savings from overseas conversions

were reflected in further reductions of £2.8 million by 1934-35. A further cause of increased expenditures was unemployment relief, so far as financed out of revenue. It is difficult to separate unemployment relief from expenditures designated "charitable" (excluding, however, hospitals from the latter item.) Taking the two together, expenditure from revenue increased £5.8 million in 1930-31 and a further £3.2 million in 1931-32, after which a greater proportion of unemployment relief expenditure was financed out of loan funds.

Economies had therefore to be confined to general administration and business undertakings. Of the latter, railways were the chief item. Reductions of £7.5 million in 1930-31 and a further £3.6 million in 1931-32 more than offset the decline in revenues, as compared with 1929-30. Total reductions in all expenditures not previously mentioned were £3.2 million in 1930-31, a further £4.0 million in 1931-32, and a further £0.8 million in 1932-33.

The chief classes of revenues and expenditures may be summarized as follows:

			£000,000		
Revenue	1929-30	1930-31	1931-32	1932-33	1933-34
Taxation	32.3	34.1	30.9	34.5	31.4
Railways	48.6	40.9	39.8	40.2	39.5
Other	34.5	33.5	33.4	33.7	34.4
Total	115.4	108.5	104.1	108.4	105.3
Expenditure					
Debt charges	37.0	41.7	46.9	42.5	41.0
Railways	41.8	34.3	30.7	30.0	29.4
"Charitable"	5.3	11.1	14.3	11.7	9.4
Other	40.1	37.0	33.0	32.2	32.5
Total	124.2	124.1	124.9	116.4	112.3
Deficit	8.8	15.6	20.8	8.0	7.0

These figures do not, perhaps, do justice to the degree of reduction in adjustable expenditures. The percentage reductions in 1931-32 as compared with 1929-30 were as follows:

Percentage Reductions in Expenditure

1931/32 as Compared with 1929/30

	Business Undertakings	Administration and General	Roads	Total
	%	%	%	%
Commonwealth	19	23	--	21
New South Wales	15	10	46	15
Victoria	32	23	32	28
Queensland	24	17	18	21
South Australia	30	19	59	29
Western Australia	27	25	39	27
Tasmania	26	17	13	20

These reductions were achieved through dismissals (chiefly in the railways) and salary cuts, the latter averaging about 20% in 1931-32 as compared with 1929-30 except for New South Wales (13%) and Queensland (15%). By 1932-33 New South Wales' public salaries and wages averaged 23% below 1929-30, but Queensland made no further reductions.

The greater ease with which the Commonwealth was able to return to balanced budgets, because it had no responsibility for railways or unemployment relief (except in each case on a very small scale) and had powers of indirect taxation, may be seen from the following:

	£000,000				
Revenue	1929-30	1930-31	1931-32	1932-33	1933-34
Customs-ordinary	30.2	16.4	15.0	16.8	18.2
Customs-primage	-	1.8	3.6	4.5	4.1
Other indirect taxes	11.6	13.5	18.3	21.0	21.9
Income tax	11.1	13.6	13.5	10.9	9.3
Other direct taxes	5.3	5.1	3.6	2.9	2.9
Post Office	13.6	12.8	12.4	12.6	13.1
Other revenue	5.3	6.4	5.1	4.8	4.4
Total	77.1	69.6	71.5	73.5	73.9
Expenditure					
Debt charges	26.1	27.0	21.2	19.7	19.2
Postal	10.6	10.0	8.4	8.3	8.5
Payments to or for states	11.5	13.1	12.1	12.5	13.2
Pensions	18.7	19.7	18.6	17.7	18.0
Farm relief	-	-	-	2.3	3.0
Other	11.7	10.5	9.9	9.5	10.7
Total	78.6	80.3	70.2	70.0	72.6
Surplus or Deficit	- 1.5	- 10.7	+ 1.3	+ 3.5	+ 1.3

The scope for economies by the Commonwealth was more limited; reductions in respect of business undertakings (chiefly the post office) and general administration were made in accordance with the Plan, but did not bulk as large in relation to total expenditures as in the case of the states. The Commonwealth had also to undertake the unpopular task of reducing pensions (war, invalid, and old age). The most important changes, however, from the point of view of the magnitude of their contribution towards overcoming deficits, lay in the higher taxation, already mentioned, and reduced debt charges. In the latter connection, the chief saving occurred through suspension of interest and sinking fund payments on that part of the War Debt that was owed to the British Government. The original debt was consolidated in 1921 in the amount of £92,480,000, under a funding agreement for extinguishing the debt in 35 years by annual payments of approximately £5,550,000. Suspension of payments on account of principal from 1931-32 took place by agreement, and of interest for 1931-32 under the Hoover Moratorium. Interest payments due in 1932-33 and subsequent years have also been suspended by arrangement. The Commonwealth Year Book for 1936 says that "the suspension of interest and sinking fund payments represented an annual saving to the Commonwealth government of approximately £7,000,000 including exchange". This amount is greater than the combined savings to all governments through the internal debt conversion. There was an offsetting factor, however, through cessation of reparation payments from Germany amounting to about £1,000,000 per annum.

Commencing with 1932-33 further important aid to all governments came from the conversions of overseas debt already described.

Finally, the increased production particularly of exportable goods, the indirect currency depreciation consequent upon Britain's abandonment of the gold standard, and the fortunate increase in wool prices two years ahead of the recovery

of most other commodity prices, mentioned below in connection with the trade balance, must have been of great assistance to government finances, for they improved national money income and thereby government revenues, without increasing government expenditures, except a small sum for exchange on service of overseas debt not payable in sterling.

(Page 125 follows)

(c) The trade balance and balance of payments

External events and good fortune contributed more to the early stabilization of Australia's foreign exchange situation than any positive action or policy on her own part. The action of Great Britain in abandoning the gold standard and permitting its currency to depreciate in terms of gold was of great assistance not only in the maintenance of Australia's favourable trade balance, a national necessity in the absence of the former annual borrowings overseas, but in assisting her export industries and contributing to the partial rectification of internal disequilibrium, as well as in expanding (or preventing further contraction of) national money income. Australian currency was pegged to sterling at a rate which was maintained with only one small change from January 1931. The banks attached great value to such stability, and certainly Australia was fortunate in maintaining a stable value for its currency in terms of sterling. But such stability, particularly at the level chosen, could not have been maintained but for sterling depreciation, and Australian currency actually fluctuated in terms of the gold currencies in exactly the same degree as did sterling. At the time the Premiers' Plan was adopted, both the sterling and the gold premium were 30%. By December 1931, six months later, the sterling premium was still 30% and was reduced to 25% in that month, but the gold premium was 80%. Otherwise put, the purchasing power of Australian currency in relation to dollars and other gold currencies was 55% as compared with 77% in June, a change which must have been of great importance in the achievement of a large export surplus in 1931-32 and subsequent years. Australian imports from countries other than the United Kingdom in 1927-28 were 57% of her total imports, the United States alone supplying 24%. In 1931-32 the percentage from the United States was only 16%.

Another important factor was the series of extremely

favourable agricultural seasons which Australia enjoyed throughout the depression. Wheat acreage, following the extraordinary increase in 1930, receded in the following years, and for three years remained at about the level of 1928 and 1929, but production showed a great increase. Comparing the four years 1926-29 with the four years 1930-33, acreage rose from an average 13.2 million acres to 15.9, an increase of 20%, but production rose from an average 141.4 million bushels to 198.9, an increase of 41%. There was likewise an increase of 7% in wool production for the same periods. Australia produces one-quarter of the world's wool, including one-half of all fine merino wool, and exports 94% of her production. The increase was particularly fortunate for the two years 1931-32 and 1932-33, production being 12% greater than the preceding two years.

Total export volume (excluding gold exports in excess of production) in 1931-32 and 1932-33 exceeded that in the preceding two years by 22%, and in the four years 1930-31 to 1933-34 exceeded that of 1926-27 to 1929-30 by 27%. In large measure resulting from the absence of widespread drought, which had previously occurred one season out of three, on the average, this great increase in volume of exports was a phenomenon which could not have been foreseen, but without which Australian depression policy might not have seemed successful. Moreover, the price of wool (and wool constitutes over 40% of total exports improved materially in 1933-34, while other world commodities remained almost stationary, the increase (in average realized price, apparently) being about 69% in terms of gold and 81% in sterling and Australian currency.

Aided by these factors, and also by the tariff increases - though the latter were gradually removed from 1932 on - a reversal of the trade balance and restoration of London reserves were achieved which appear remarkable in view of the much more rapid and severe decline in export prices than in import prices. (Import prices, given by MacLaurin as furnished by the New South Wales Bureau of Statistics, are merely the internal price of imported goods; they do not constitute "import prices" in the ordinary sense of the term, but are believed to be accurate enough for present purposes, and are the only statistics of import prices in Australia.)

Taking the annual average of 1925-26 to 1928-29 as 100, the following index numbers show the disparity:

	Average 1925-6 to 1928-29	1929 -30	1930 -31	1931 -32	1932 -33	1933 -34	1934 -35	1935 -36
Import Prices	100	95	95	93	89	87	87	87
Export Prices	100	74	58	56	56	74	61	75
Ratio of export index to import index	100	78	61	60	63	85	70	86

(The sudden improvement of export prices in 1933-34 is largely a reflection of the great increase in wool prices in that year. The foregoing figures are based on Australian currenc and therefore understate the decline in all prices, but this does not greatly affect the comparison between exports and imports.)

Export volume (merchandise, including exports of gold to the extent of production but not excess specie exports), and value of exports and imports in sterling, in index numbers to the same base, were as follows:

	Average 1925-26 to 1928 -29	1928 -29	1929 -30	1930 -31	1931 -32	1932 -33	1933 -34	1934 -35	1935 -36
Export volume	100	105	95	118	126	133	120		
Export value	100	100	71	57	57	59	69	63	76
Import value	100	95	86	40	29	38	39	48	55

The value of merchandise exports (as defined above) and imports, the merchandise balance, and the total balance on current account, were as follows, expressed in millions of pounds sterling:

	1928-9	1929-30	1930-1	1931-2	1932-3	1933-4
xports	140.0	98.1	79.9	80.7	84.4	98.0
nports	149.7	138.8	64.0	47.3	61.0	64.1
erchandise Balance	- 9.7	- 40.7	+15.9	+33.4	+23.4	+33.9
urrent account lebit or credit	-42.3	- 72.7	-14.9	+ 7.4	- 4.5	+ 5.1

The manner in which gold reserves were depleted, and foreign currency reserves depleted and then accumulated again, may be seen from the following:

Net available reserves of "international currency" at June 30

£000,000 gold value

	1928	1929	1930	1931	1932	1933	1934
old	46.4	45.5	21.2	15.7	11.0	0.9	0.9
ther	60.0	47.3	15.3	11.5	18.6	31.1	41.2
otal	106.4	92.8	36.5	27.2	29.6	32.0	42.1

Increase or decrease during year ended June 30

old	- 0.9	-24.3	- 5.5	-4.7	-10.1	--
ther	-12.7	-32.0	- 3.8	+7.1	+12.5	+10.1
otal	-13.6	-56.3	- 9.3	+2.4	+ 2.4	+10.1

The efforts made to support the external value of the currency, particularly in 1929-30, are reflected in the table. It is also apparent how vulnerable was the position from 1931 to late in 1933. A single crop failure would probably have forced further depreciation. The increase in reserves in 1933-4 seems to be the direct result of the rise in wool prices. The above table is expressed in gold values. Since the Australian currency is tied to sterling, and nearly all debt payments abroad are payable in sterling, a more realistic presentation will be afforded by expressing reserves in sterling values as follows:

£000,000 sterling

Net available reserves of "international currency" at June 30

	1928	1929	1930	1931	1932	1933	1934	1935	1936
Gold	46.4	45.5	21.2	15.7	14.8	1.3	1.4	1.3	1.4
Other	60.0	47.3	15.3	11.5	25.1	45.0	66.8	45.3	49.2
Total	106.4	92.8	36.5	27.2	39.9	46.3	68.2	46.6	50.6

Increase or decrease during year ended June 30

	1929	1930	1931	1932	1933	1934	1935	1936
Gold	- 0.9	-24.3	- 5.5	-00.9	-13.5	+ 0.1	- 0.1	+0.1
Other	-12.7	-32.0	- 3.8	+13.6	+19.9	+21.8	-21.5	+3.9
Total	-13.6	-56.3	- 9.3	+12.7	+ 6.4	+21.9	-21.6	+4.0

(These tables show the net available reserves as calculated by the Commonwealth Statistician in an article entitled "London Funds and the Australian Economy" in the March 1935 Supplement to the Economic Record. The net figure is defined as the difference between (a) "assets" consisting of visible stocks of gold, gold in transit overseas, and net overseas assets of trading banks and of the note issue and banking departments of the Commonwealth Bank, and (b) "liabilities" consisting of the net amount of all short-term government debt (securities and overdrafts less credit balances) domiciled overseas. Dr. Wilson's figures continue only to 1934. The figures for 1935 and 1936 are estimates on the same basis from available data and are believed to be approximately correct within 4 or 5 per cent.)

(d) Wages

Despite the various reductions in nominal wages, under Arbitration Court awards and otherwise, the index number of real wages for those in full time employment did not decline during the depression over Australia as a whole. The following index numbers for all industries in all states are taken from the latest Commonwealth Year Book. The price series relates only to prices in the six capital cities (which comprise the bulk of the wage-earners). The real-wage series is obtained simply by dividing the index of nominal wages by the index of retail prices, which cover food,

groceries, clothing, rent of four-and five-roomed houses, and miscellaneous household requirements. In order to follow the course of wages during the depression, all index series have been converted to a new base, simple average of four years 1926-29 = 100.

Nominal and Real Wage Indexes for Adult Males (Full Work) - Weighted Average for Australia as a Whole.

Yearly averages:	Nominal Wages	Retail Prices	Real Wages	Real Wages Highest State	Real Wages Lowest State
Simple Average 1926-29	100	100	100		
1928	101	100	101	102	100
1929	101	102	99	102	98
1930	99	96	103	107	101
1931	90	86	104	105	102
1932	84	82	102	107	98
1933	81	80	102	108	98
1934	82	80	101	107	98
1935	83	82	101	105	97
1936	84	84	100	103	97

It thus appears that the decline in prices preceded the decline in nominal wages, so that real wages rose in 1930 and 1931, declined in 1932 as the cuts in nominal wages continued, and have since declined with the rise in prices. The variation was insignificant when compared with the variation in agricultural income. Among the several states, New South Wales and South Australia were well above their respective 1926-29 averages in 1930 and 1931. From 1933 on, all but Queensland have held close to their 1926-29 averages; Queensland has been well above its previous level. The 10% reduction in the basic wage decreed by the Commonwealth Arbitration Court early in 1931 should, after a time-lag, have accomplished a ten per cent reduction in real wages, and, in fact, the Court remarked, in course of a wage decision in May, 1933, that about one-half of all workers in Australia had experienced such a reduction, as compared with the level of 1928. This would presumably apply to (a) those workers whose wages were subject to the Court's jurisduction (both directly under wage awards, and indirectly under wage agreements filed with the Court which, while often providing for higher wages than those awarded by the Court, usually also provide for or result in changes in wages, after a considerable lag, of much the same degree as changes in the basic wage) (b) those under the jurisdiction of the Victorian and Tasmanian state tribunals whose awards closely approximated the awards of the Commonwealth Court, and those not affected by any wage tribunal. It would appear that the remaining half of the workers must have experienced an increase

of at least ten per cent in real wages, since the average for all Australia showed little change from the pre-depression level. The differential arose from the action of state tribunals, most of which did not impose reductions as large as those imposed by the Commonwealth Court.

Industrial relations in Australia are characterized by a high degree of public regulation, which, however, is complicated by overlapping of Commonwealth and state jurisdiction, duplication of awards and, in consequence, variations of wages, hours of work and other matters even in the same industry. Each of the six states has its own industrial laws and its own industrial tribunal.

Commonwealth jurisdiction rests upon clause 35 of section 51 of the Constitution Act, whereby the Commonwealth Parliament is given power to legislate with respect to "conciliation and arbitration or the prevention and settlement of industrial disputes extending beyond the limits of any one state." In pursuance of that power, the Commonwealth Court of Arbitration and Conciliation was established in 1904, with power to settle any dispute, of an interstate character, brought before it, but no power to regulate wages or other matters of its own motion.

Within a few years of its establishment the Court had adopted a fundamental concept which has been the basis of its jurisprudence ever since-- the "basic wage." This idea first received legal status in 1907, when the President of the Court, called upon by the Excise Act to give his own interpretation of what constituted "fair and reasonable" remuneration, declared that such words must be meant to secure for employees "something which they cannot get by the ordinary system of individual bargaining with employers." "I cannot think of any other standard appropriate than the normal needs of the average employee regarded as a human being living in a civilized community." Acting on this broad definition, he laid down the minimum wage for unskilled labour which has since been called the"basic wage."

Since 1913, adjustments have been made quarterly in accordance with changes in retail prices, with a separate adjustment for each city, town, and district. The actual minimum wage payable in any industry under the Court's jurisdiction will be the "basic wage" as so adjusted, plus any "loading", defined as an addition to the wage as compensation for some peculiar condition of labour or environment. Skilled labour receives a wage that is greater, in varying degree, than such primary wage. The "basic wage" remained unchanged, save for "loadings" and price-change adjustments, until 1931, when it was reduced by 10 per cent. In 1934 it was re-calculated, with only part of the reduction of 1931 incorporated in the new "basic wage", and the index of retail prices has been rendered more comprehensive. In 1937 wages were increased through additional "loadings". The highest "basic wage", including "loadings", is now 78s. per week, in Sydney.

As the Court's earlier decisions generally awarded higher rates of wages and better conditions of labour than state tribunals, many trade unions contrived to come under its jurisdiction, by federating with unions in other states, registering with the Court, and provoking a dispute with employers in the industry which employed their members in two or more states. At the end of 1929 the number of unions registered with the Court was 137, with about 770,000 members, or about 85% of the total trade union membership in Australia. However, most of the Court's awards do not apply to all states, but to varying numbers of states according to the industry in question, and it has been estimated that in 1929, there were only about 400,000 unionists working directly under Commonwealth awards; including those indirectly affected, the number would be about 800,000.

There are three limitations to the Court's jurisdiction: first, it extends only to interstate disputes; second, it can act only when a dispute is brought before it by a recognized organization, and therefore does not affect unorganized workers; thirdly, it can only settle actual disputes (or enforce the observance of actual collective agreements which on registration with the Court

acquire the force of an award) and therefore cannot declare a common rule, or extend any award to all persons working in the industry affected.

Thus in 1929 there were about 1,600,000 workers (80% of the total) not directly affected by awards of the Court, of whom perhaps 1,300,000 would have their wages and working conditions determined, if at all, by state tribunals, all of which have power to declare their awards to be a common rule of an industry. The result is that, while any particular employee will be subject to only one jurisdiction, there may be two or more authorities governing the wages of the various members of a single union, or the employees of a single employer, or workers in one industry. If an employer was not a party to a dispute decided by, or agreement filed with, the Commonwealth Court, he and all his employees come under state law. On the other hand, the employer and such of his employees as belong to a particular union may be bound by a Commonwealth award in their relations with each other, while non-unionists, and the employer in his dealings with them, are not. A non-unionist who joined such a union would become subject to the award; a unionist on leaving the union comes under state law. When the Commonwealth Court has jurisdiction and has made an award, or received a collective agreement, state law must give way, but only with respect to the actual parties involved. A further complication arises from the fact that all the states and many municipalities carry on "business enterprises". The High Court has held that so far as such instrumentalities are industrial enterprises and become involved in an interstate dispute, the Commonwealth Court has jurisdiction. Wages of workers in the state railway systems have thus largely been determined by Commonwealth awards.

The chief limitation on the powers of the Commonwealth Court, whereby it can deal only with actual disputes between parties, arises from the wording of the constitution as interpreted by the High Court, and apparently could only be removed

by constitutional amendment.

Except for Western Australia and Queensland, the Court's basic wage in each state was for years as high as or higher than that declared by state tribunals. In the two states mentioned the reverse was the case, and workers naturally showed a preference for state awards. This tendency became general in most states in 1931 when the Commonwealth Court reduced its basic wage by 10 per cent and state tribunals were rather slow to follow suit. In New South Wales, where wage adjustments are not made automatically in accordance with price changes, but by periodic reviews by the Industrial Commission, the state basic wage, under the influence of the government, showed little change until late 1932. The Premiers' Plan Conference had left the carrying out of the recommendation of the Copland Committee with regard to reduction of wages to the individual states. Victoria and Tasmania closely adhered to the standard suggested, namely, a 10 per cent reduction in real wages. The other four states diverged in varying degree; none of them brought wages down to the same extent as the Commonwealth Court, as is obvious from the course of average real wages in the depression years. Apparently, so far as the Copland Committee's recommendation was followed, it was the 20 per cent reduction in nominal wages which was adopted; in the middle of 1931 this would have meant a 10 per cent reduction in real wages, but by the following year prices had declined further so that a reduction in nominal wages of 20 per cent (compared with 1929) accomplished no reduction in real wages.

(e) Unemployment Relief.

Unemployment in Australia was probably as severe as anywhere in the world. It was left to the states to cope with both the problem of unemployment and the financing of relief.

The indices of unemployment in Australia usually quoted are the figures obtained by the Commonwealth Statistician from certain trade unions. Returns are not collected from unions whose members are in "permanent" employment (such as railway and tramway employees and civil servants) nor from those whose members are casually employed (wharf labourers, shearers, etc.) The combined membership of unions from which returns are collected has varied in the past ten years from 400,000 to 440,000, the total thus comprising about one-fifth to one-quarter of all wage-earners. For Australia as a whole, the statistics so obtained appear to be the best available, although for individual states a considerable margin of error has been indicated in some cases, such as on the occasion of the Census of 1933. The basic trend of Australian unemployment may be seen from the percentage figures according to the trade union returns, as follows (annual averages):

	Highest state	Lowest state	Australia
Average 1923-27			7.8
1928	15.0	7.0	10.8
1929	15.7	7.1	11.1
1930	23.3	10.7	19.5
1931	32.5	16.2	27.4
1932	34.0	18.8	29.0
1933	29.9	15.3	25.1
1934	25.6	11.7	20.5
1935	20.6	8.7	16.5
1936	15.4	7.8	12.2
1937	10.9	5.6	9.3

From 1928 to 1934 South Australia was the highest, with New South Wales a close second; Queensland had the lowest percentage, with the other three states fairly close together

in a midway position. From 1935 to 1937 New South Wales was the highest, Queensland the lowest with the other four varying in between.

A discussion of unemployment in Australia and measures of relief is subject to a peculiar difficulty. "Relief works" were undertaken on a large scale in most states. The works so denominated covered the whole field of what had been ordinary public works before the depression so that relief works were essentially a continuation of such public works, on a different basis and a considerably smaller scale and with lower wage scales in some cases but to a large extent giving employment to the same labour force. A striking illustration is that in most states expenditure on roads from the Federal Aid Roads grants (which commenced in 1926) is classed as an expenditure on unemployment relief works although total expenditures on roads were much less than they were prior to the depression. A large number of persons were therefore classified as on relief, who were doing the same work they had been doing prior to 1930, for the same employer, when they were not regarded as unemployed. The real difference was that they were getting, in some cases, lower wages, and certainly a lower income since work was usually rationed so that no man could obtain such work for more than a stated number of consecutive weeks, or in some cases for more than a few days each week.

The extent of public works expenditure in the late twenties really masked what otherwise would have been a serious unemployment situation, and the cessation of such expenditure was the largest single contribution to the unemployment problem. Dr. F.C. Benham ("The Prosperity of Australia", 2nd edition, p. 210) is quoted by McLaurin as noting that a Royal Commission found in 1926 that the greatest percentage of unemployment at that time was among unskilled and casual labourers, his conclusion being that the basic wage for unskilled labour was too high for private employers to make profitable use of such labour.

At any rate, public works employed a very large number of unskilled labourers, and it has been estimated that "the immediate effect of the cessation of public works was to throw approximately 200,000 men out of employment". From 1924-25 to 1928-29 the combined net loan expenditure of Commonwealth and states averaged about £40,000,000 annually, the amount being very nearly constant for each of these years, and while this includes several items not classified as public works, it gives some idea of the magnitude of such expenditures. (State expenditure constituted nearly 80% of the total.) In 1929-30 and 1930-31 the comparable figures were approximately £ 30 millions and £15 millions respectively, indicating the cessation of spending when overseas borrowing of necessity came to an end and internal borrowing became more difficult and finally also came to an end save for borrowings from the banks.

The course of state loan expenditures on works subsequent to 1930-31 is shown below. "Net" loan expenditures are shown first, for comparison with pre-depression spending. Figures on "gross" loan expenditures are only available commencing in 1932-33, and only for the states. Commonwealth expenditures were in any case very small. Relief works financed out of loan funds (included in the total net and gross loan expenditures) are next shown, followed by relief works financed out of revenue, and, finally, direct relief (financed from revenue). Net loan expenditure is not accurately defined, but seems to mean gross expenditure less repayments to loan funds, e.g. by local authorities to whom money had been lent by a state for works purposes, and by returned soldiers and other settlers.

State Loan Expenditure and Unemployment Relief

£000,000

	1930-1	1931-2	1932-3	1933-4	1934-5	1935-6
Net loan expenditure	12.5	6.2	10.0	14.5	18.6	18.8
Gross loan expenditure			14.6	19.0	23.8	24.2
"Relief Works" from loan	-	2.4	6.9	11.7	14.4	12.5
"Relief Works" from revenue	1.8	2.3	3.2	2.2	2.4	4.1
Direct relief, from "	6.5	8.3	6.1	4.4	3.9	3.6

The above unemployment relief expenditures, based largely on the Ince Report (see below) with one or two lacunae filled from nformation in Commonwealth Labour Reports, do not profess to be strict-y accurate, either in total amount, or in the classification adopted bove. The available statistics are very imperfect, and are confused y differences in definitions, classifications, and presentation among he several states. There is an obvious conflict between the increase n total expenditures after 1932 and the decrease in unemployment per-entages, accounted for chiefly by the description of a large amount f ordinary public works as "relief works", by the increase in work elief and decrease in direct relief after 1931-32, and by the fact hat in the early years of the depression many unemployed persons were ble to do without relief.

It is impossible to obtain even reasonably accurate figures or the number of persons receiving relief in all states. Direct relief eached its peak (in money spent) in 1931-32, and the total of persons including dependents of unemployed persons) receiving "sustenance" at une 30, 1932, was 673,840 according to the Commonwealth Government abour Report for that year. Subsequent years' figures do not seem eliable, and in any event the great increase in relief works renders ny statement of those receiving sustenance devoid of much significance. nformation with respect to those engaged on relief works is not atisfactory. Such figures, if available, would to some extent duplicate ne sustenance figures, e.g. in the case of works schemes providing orks for three or four days a week.

Measures for the relief of unemployment varied among the tates, from South Australia which provided no work relief, to Queensland nich appears to have largely avoided the dole and to have designated early all its public works expenditures as relief works. (Queensland s the only state possessing an unemployment insurance scheme. It was, f course, far from adequate to meet the great amount of unemployement in ne depression). For comparison, (although in the circumstances compa-isons between states are of little value) total expenditures of each tate for the six years 1930-31 to 1935-36 are shown below,

subject to the same caveats as previous figures. Per capita figures are based on mean population for the calendar year 1936.

£000,000

	Relief Works From Loan	Relief Works From Revenue	Sustenance (from revenue)	Total	Total per capita
New South Wales	18.4	2.3	16.6	37.3	£14.0
Victoria	6.1	2.2	8.6	16.9	9.1
Queensland	14.7	10.7	1.4	26.8	27.4
South Australia	-	0.3	3.8	4.1	7.0
Western Australia	8.4	0.4	1.9	10.7	23.8
Tasmania	0.4	0.2	0.5	1.1	4.8
All states	48.0	16.1	32.8	96.9	14.3

The federal contribution for unemployment relief as such was very small; the federal government did not undertake unemployment relief works and in fact in the years 1930-31 to 1934-35 almost completely ceased its ordinary public works expenditures which had never been very large. Commonwealth contributions to the relief of unemployment were as follows: in 1929-30, a special payment to the states of £1,000,000 taken from the Roads Fund; in 1930-31 a similar amount of £750,000, and in 1931-32, £304,000. In 1932-33 there was a special interest-free loan to the states of £1,800,000, conditional upon the latter raising a total amount of £1,200,000, the whole to be spent on approved reproductive works. In 1933-34 the Commonwealth gave £300,000 to the states. In 1934-35 the Lyons' government went considerably farther. In the election campaign in August of 1934, Mr. Lyons promised that unemployment would be handled "upon a national as well as a state and municipal basis.......... The government has also in mind works of some magnitude, such as the unification of railway gauges between capital cities, country water storage, sewerage construction for large country towns, and other works of like description which meet public needs...... The government will enter upon the scheme in a spirit of generosity, impelled

by a sense of inevitable responsibility." During the year 1934-5 the Commonwealth spent on works £161,000 from revenue and £400,000 from loan fund under the Loan Appropriation (Unemployment Relief) Act of that year. In addition, this Act authorized loans to states, under which appropriations amounted to £1,000,000 for public works, £283,750 for assistance to metalliferous industry, and £322,000 for forestry work. In the next three years the chief assistance was in connection with the latter two items in comparatively small amounts. Most of the federal contributions were thus disbursed to the states, the Commonwealth itself undertaking no unemployment relief, and the sums in question are probably included in the totals of state expenditures given above. In addition, at least some of the states classified expenditure of the Federal Aid Roads grants as unemployment relief. These averaged about £2 million per year, but, like the Commonwealth payments to states under the Financial Agreement, cannot be regarded as federal contributions to unemployment relief as such.

Other Commonwealth payments that can be ascribed to the needs arising out of the depression were relief to primary producers in the years 1932-33 to 1935-36, aggregating about £16,000,000 (chiefly wheat bounties) and increases in the special grants to Western Australia, Tasmania and South Australia. These three states received special grants to a total of £12,390,000 in the six years 1930-31 to 1935-36, as compared with £3,560,000 in the previous six years. There was also a special distribution to all states in 1934-35 out of accumulated Commonwealth surpluses, the amount distributed being £2,000,000.

In 1936 the Commonwealth government requested the British government to make available officials dealing with unemployment insurance to assist in investigating the feasibility of establishing a scheme in Australia. The Chief Insurance Officer in the Ministry of Labour (Mr. G.H. Ince) went to Australia, and submitted his

report in 1937. The report concludes that it would be feasible to establish contributory unemployment insurance, and recommended a national scheme rather than separate state schemes. "An Australia-wide scheme under the control of the Commonwealth ensures uniformity, spreads the risk of unemployment throughout the Commonwealth, and treats it as an industrial unit for insurance purposes" (summary, p.39 of the Report).

(f) Assistance to Agriculture

The assistance received by the agricultural and pastoral industries, particularly those producing for export, from currency depreciation -- assistance coming to such industries as a by-product of actual depreciation and not as the objective of a policy of depreciation, has already been mentioned. The desire of the economists for equal sharing of the loss in national income was, of course, never achieved. Export industry bore the entire burden, except for wage-earners who lost employment altogether, for the first year and a quarter of the depression. Even after the two great measures of currency depreciation in 1931, and the wage and interest reductions in 1931 and 1932, farm prices in 1932-33 were only 60% of the 1924-29 average, while costs were about 80%, according to the estimates of Professor Giblin, and the situation did not greatly improve until the second half of 1935. The figure for general farm prices also obscures the fact that sugar, butter, cheese, dried fruits and a few other products were protected by tariffs, fixed domestic prices, and subsidies, and did not fall the full 40%, while prices of the export products, wheat and wool, fell more than 40%. Moreover, even the special assistance to wheat growers has been included as part of the "price" of farm products, so that the position of Australian farming, at the virtually stabilized level of 1932-3 to 1934-5, is presented at its best by the foregoing percentage figures, subject to this, that total production increased 16%, which would benefit the farm industry so far as the increase occurred in respect of such products as could still be produced at a profit.

The direct assistance given to agriculture by the Commonwealth may be summarized briefly. Butter producers were protected from the full force of the drastic decline in export price by the bounty, which they first received in 1926; this

was financed, until 1934, by a levy on domestic consumption (imposed not by the government but by the industry itself, under the protection of a tariff which in 1927 was raised to 6d per lb.) which was reflected in the domestic price; the domestic price at the lowest (1932) was 61% of the 1929 price. The decline was slower than for wheat and wool, the domestic price in 1931 being 76% of the 1929 level. (Export price of Australian butter in London declined to 60% in 1932 and 50% in 1933, of the 1929 level.) Exports in 1931-2 were double those of 1928-29 and previous years and went on increasing.

Sugar producers were assisted by continuance of the fixed price system embodied in agreements between Queensland and the Commonwealth. From 1925 to 1932 the price of raw sugar remained fixed at £26 per ton, and the retail price for refined sugar at 4½d. per lb. In 1932 the Lyons government secured a reduction of ½d. per lb. or 11%. The industry had to export from 35% to 50% of production, however, and had to use its bounty from high domestic prices to offset the reduced export prices -- a reduction to 79% of the 1928-9 level in 1930-1, rising to 89% in 1931-2 and then steadily declining to 66% in 1934-5.

No assistance was given to wool, but wheat growers received special consideration, for the first time, from the Commonwealth government. In 1931-32 a bounty of 4½d. per bushel was paid. In 1932-3 and 1933-4 so-called "relief" was given. This was really a bounty to all wheat farmers, distributed by the Commonwealth through the state governments on an acreage basis. In 1934-35, in accordance with the recommendation of the Royal Commission on the Wheat, Flour and Bread Industries, there was a bounty of 3d. per bushel, and in addition "relief" of 3s. per acre. Special relief was also given to farmers suffering from adverse weather conditions. In 1935-36 there was general "relief". The amounts of these various payments were as follows:

1931-32	Bounty		£ 3,429,314
1932-33	Relief		2,000,000
1933-34	Relief		3,053,000
1934-35	Bounty Relief Special relief	1,462,414 2,004,944 573,250	4,040,608
1935-36	Relief		1,878,906
Total, five years			14,401,828
Total excluding special relief			13,828,578

The "home price system" being so well-established in Australia, it was applied to wheat, on the recommendation of the Royal Commission, the payments in 1934-5 and part of 1935-6 being financed by a processing tax on flour, but this was discontinued in February 1936.

Total expenditures designated as "relief to primary producers" in the Commonwealth's accounts, together with wheat bounties, amounted to £15,700,000 in the five years 1931-32 to 1935-36. There was none in 1930-31 and only £327,000 in 1936-37. These sums are exclusive of production and export bounties, under the many Bounty Acts, in connection with iron and steel products, sulphur, flax, wine, cotton, cocoa, coffee, fruit and gold, which averaged £450,000 per annum from 1930-31 to 1935-36 as compared with £525,000 in 1928-29 and 1929-30.

Action by the states to assist agriculture by special depression measures seems to have been chiefly by way of Debt Adjustment Acts. As in Canada, these were essentially moratoria, with the creditor subjected to a stay of proceedings if he did not agree to a compromise which seemed reasonable to the Director, (administrator of the Act) and the debtor subject to removal of the protection if he was recalcitrant. Debtors were left to bankruptcy laws if too deeply in debt. A feature of the acts in some states was that control over the proceeds of crops of farmers taking advantage of the Act was vested in the Director, and that advances for subsistence and farm

operations were made from funds supplied by the state, repayment of such sums being a first charge on the crop proceeds.

In 1935 the Commonwealth parliament passed the Loan (Farmers' Debt Adjustment) Act whereby grants to a maximum of £12,000,000 were authorized to be made to the states out of the Commonwealth Loan Fund, over a period of several years, to assist in the composition of farmers' debts. The chief use of the money is to pay off unsecured creditors who are willing (or a majority of whom are willing) to accept a reduced amount in cash in full settlement of their claims. No grant could be made to any state until it had set up a board or other authority to suspend farmers' debts in whole or in part. Total expenditure by the Commonwealth to the end of June 1937 was £1,817,000.

The difference between the farm debt situation in Australia and Canada may be seen from the following summary of the classification of creditors of wheat farmers published by the Royal Commission on the Wheat, Flour and Bread Industries (Second Report, 1935, p. 234):

		£000,000
Secured Creditors		
Government organizations (other than state banks)	30.0	
State banks	20.4	
Commercial banks	33.1	83.5
Financial institutions	14.5	
Private mortgagees	38.1	52.6
Unsecured Creditors		15.3
		151.4

Summarizing, primary producers in Australia received assistance, directly or indirectly, and as the result of policy directed to that end or as the by-product of other happenings, in the following forms: currency depreciation; general interest reductions; maintenance of domestic prices; direct subsidies; special drought relief (the least important item owing to the absence of widespread drought); debt moratoria and debt adjustments; direct grants to facilitate debt adjustment; reduction

of costs through reduction of wages generally and especially reduction of wages of farm labour. The total amount of such assistance, of course, cannot be measured.

(g) Annual Value of Material Production

The following index numbers have been constructed from estimates of the gross value of non-manufacturing production (agricultural, pastoral, dairy and poultry farming, forestry, fisheries and mining) and net value of manufactures as published in the Commonwealth Year Book. The construction industry and the value of services are not included. Production per head of population has been given both on the basis of money-value and of purchasing power as measured by the "all-items" index of retail prices, the latter having been used both because it is adopted by the Commonwealth Statistician and because Australian wholesale price indexes are unsatisfactory and are in process of revision.

	Primary Production	Manu-facturing	Total Production	Total Production per head of population: Money Value	Total Production per head of population: Adjusted to Purchasing Power
verage of four ears 1925-26 to 928-29	100	100	100	100	100
928-29	99	104	101	98	97
929-30	83	97	88	84	84
930-31	71	73	72	68	75
931-32	68	69	69	65	77
932-33	70	74	71	67	84
933-34	80	80	80	75	93
934-35	75	91	80	74	91
935-36	85	101	91	83	101

These figures would indicate that the depression in Australia touched bottom some time in 1931, so far as concerns the value of material production, particularly when regard is had to changes in the price level, although on a per capita

basis there was little improvement until late 1932 or 1933. In 1932-33 the price decline conceals the very great improvement in the real value of total production, an improvement which is apparent from the figures in the last column of the table. Imports also increased substantially in 1932-33, the real indication of returning prosperity. As between primary and secondary industry, the depression in the former came sooner and more suddenly, was of greater severity, and lasted longer, than in the latter, and among primary, industries, those producing for export, particularly wheat and wool, suffered most.

Total value of production in the various industries is, of course, only a rough guide to their relative depression-experience, which is complicated by both temporary and permanent changes in volume, costs and prices. Mention has already been made of Professor Giblin's estimate that, at the more or less stable price level (except wool prices) of 1932-33 to 1934-35, farm prices averaged 60% of the pre-depression (average 1924-29) level, while farm costs were about 80% of their former level. At the same time, volume of farm production had increased by about 15% and the physical quantity of factory production, greatly reduced at first, was back to the pre-depression figure by 1933-34. There is some evidence of a permanent decrease in the proportion of primary to secondary production. By 1934-35 the number of factory employees was up to the virtually stationary level of the three years 1926-27 to 1928-29; there was a 10% increase in 1935-36, and, although exact figures are not available, a further substantial increase (as in all other lines of activity) in 1936-37. This striking recovery in secondary production was assisted by exchange depreciation, and perhaps in equal degree by the reduction in nominal wages (a much greater reduction than in the United Kingdom, for example, the chief source of Australian imports) and by a great improvement in technical efficiency.

(h) Monetary policy.

(i) The exchange rate.

The actual course of the exchange rate has already been described. Recapitulating, between November 1929 and January 1931 the rate moved from par to a premium of 30% for sterling and gold. By December 1931, the gold premium was 80%, sterling still 30% but changed to 25% in that month. The sterling premium has since remained at 25%, with the gold premium varying in accordance with fluctuations in sterling.

From the mobilization of gold reserves in November 1929 and prohibition in December of private export of gold, until December 1931, the banks and the Commonwealth Bank worked together to control the rate. In January 1931 substantial depreciation in the "official" rate was forced by the pressure of the open market. From September 1931 onwards, no doubt partly due to sterling depreciation, London balances began to accumulate, and the banks felt that they might not be able to hold the exchange at £130. Stability rather than a return to the former sterling parity was desired, and at the request of the trading banks, the Commonwealth Bank agreed, in December 1931, to take control of the exchange rate. It immediately reduced the rate to £125 and has been able to hold it there ever since. This was done during the federal election campaign. The new Lyons Government declared they would leave the management of the rate entirely to the Bank.

In 1932 and 1933 there was some agitation for further depreciation. It was argued that over half of Australia's exports went to countries of the sterling bloc, that sterling prices were still very low, and that a much higher rate than £125 was necessary to assist exporters. The Wallace Bruce Committee, appointed by the government to make a survey of economic conditions in Australia for the April (1932) Premiers' Conference and advise whether any form of government action

would be of assistance in stimulating recovery, recommended that a further reduction in wages coupled with more exchange depreciation would help to establish equilibrium. The Prime Minister expressed his concurrence, but the government would not interfere with the Bank. The latter did not follow the committee's recommendation. At the time London funds were declining, but export prices shortly began to rise, and the Bank was able to maintain a stable rate. Primary producers desired greater depreciation but did not push their agitation very far. In particular, the graziers were mollified when wool prices rose substantially in the autumn of 1933. In 1934-35 a rise in imports accompanied a decline in wool prices, the excess of exports over imports fell, some foreign balances in Australia were repatriated, and other items contributed to a fall of £14 million (estimated) in London funds. The Bank declared it was its deliberate policy to maintain a steady exchange rate on sterling, and the strain passed with the recovery of export prices in 1935.

(ii) Currency

There was no currency inflation in Australia. Between June 30, 1929 and June 30, 1931 "notes in circulation" increased from £42.8 million to 50.6 million, reduced to £47.6 million by June 30, 1933. The increase, however, was an increase in the holdings of the banks, which appear to have taken notes in part payment for the transfer of their gold reserves to the Commonwealth Bank; the balance of such payment was reflected in increased deposits of the banks with the Commonwealth Bank.

The heavy exports of gold by the banks in an effort to maintain the exchange rate, and in the course of the Commonwealth Bank's stabilization operations, necessitated changes in the legislation respecting reserves against the note issue. The previous requirement had been a gold backing of 25%; in June 1931 the proportion was reduced to 15% with provision for

gradual restoration to 25% over a period of four years, and in May 1932 a further amendment to the Commonwealth Bank Act allowed part or all of the note issue reserve to be held in sterling. As a result, the Bank had converted virtually all the gold reserve into sterling by June 30, 1933.

(iii) Treasury Bills and credit expansion.

Since public loans could not be floated during the years 1930-31 and 1931-32, the heavy deficits of those years, as well as borrowings for loan expenditures on public works, had to be financed through the banks. Government bank borrowings, chiefly to cover lags in revenue, had previously been by way of overdraft. Three-months treasury bills appear to have been instituted in 1927, but were merely temporary issues prior to 1929. At June 30, 1930 the amount of such internal bills outstanding was £2.3 million. The amount increased rapidly to £20.6 million at June 30, 1931 and £45.0 million at June 30, 1932 and £51.2 million at September 30, 1932, since when variations in the total outstanding appear to have been chiefly seasonal.

Short-term debt of Australian governments in London also rose rapidly during the years of crisis. The amount was negligible in June 1929, but was £34 million sterling a year later, of which all but £5 million was by way of overdraft. By June 1931 the amount was £43 million sterling, of which £38 million was represented by short-term debentures, for the most part held by the Commonwealth Bank. Virtually all of this external floating debt was incurred when governments drew upon the banks' holdings of gold and sterling to meet overseas interest payments. The trading banks received cash in Australia in place of gold; the Commonwealth Bank in turn received short-term debentures for the gold so taken over. In the result, there was no change in trading banks' cash reserves from these operations, but there was a reduction in the cash reserve ratio of the Commonwealth Bank.

However, the liquidity of the trading banks had been greatly reduced by their exports of gold prior to December 1929, and by the decline in their London funds. The expansion of internal treasury bills in part offset this development; it increased the trading banks' liquidity, lessened their need to reduce advances, and enabled them to increase advances when economic recovery provided the necessary stimulus.

The treasury bills were all taken up in the first instance by the Commonwealth Bank, which then sold part or all of each issue to the trading banks. The latter showed little desire for the bills prior to June 1931, and indeed up to that time the amount taken by the banks had no expansionist effect, since they regarded the bills simply as short-term debentures, forming part of their total advances and securities. There being no internal money market, the bills were not marketable securities and were regarded as no better than government overdrafts. In December 1930, however, the banks and the Commonwealth Bank had agreed that all further borrowing by governments must be carried on by means of treasury bills only, to be issued by the Commonwealth Government, when approved by the Loan Council, in respect of both Commonwealth and state borrowings. During the next three months an additional £11 million in bills were issued, of which £10 million were taken by the Commonwealth Bank, the other banks taking less than half a million despite the 6% rate. The government spending so financed by the Commonwealth Bank increased the cash reserves of the trading banks to the same extent as their deposits; whereas if it had been financed by ordinary borrowing from the banks, an equivalent decrease in advances to private borrowers would have been necessary in order to maintain the same ratio of cash to deposits. Since at this time the banks were endeavouring to improve their liquid position, the inference is that the effect of increased central bank credit to governments lessened the contraction of commercial credit which otherwise would have been deemed

necessary by the banks, if they had had to make advances to the government.

The Commonwealth Bank, however, was not favourably disposed towards this expansion of credit through its financing government deficits, particularly in view of the probable continuation of such deficits on an even larger scale. In April 1931 the Chairman wrote to the Loan Council stating that the Bank would be unable to supply money for government borrowing beyond an amount which, it was clear, would be reached by the end of June. This letter led directly to the decision of a majority of the Loan Council to appoint the Committee whose report constituted the basis of the Premiers' Plan. Once the control over budgets was so established, the Bank permitted continued borrowings to meet the still inevitable but much reduced deficits. A change was made, however, with respect to the treasury bills. The Commonwealth Bank gave the trading banks its guarantee to meet such bills at maturity, and to rediscount them at the face rate upon demand. The result was that the increase in the trading Banks' holdings of these bills between June 1931 and September 1932 was almost exactly equal to the increase in total bills outstanding. This was not, however, a reversion to the old method of overdrafts under a different guise, nor was the purchase of such treasury bills by the banks simply an ordinary purchase of securities. The discountability of the bills rendered them the equivalent of cash in the eyes of the banks, so that they formed part of their cash reserves, in effect, whether or not so classified. Government deficits thus continued to have the effect of improving the liquidity of the trading banks. The issue of the bills did not force the banks to restrict their advances, as would have been the case if the banks had invested in government securities not capable of being turned into cash on application to the Commonwealth Bank.

The Report (1937) of the Royal Commission on Monetary

and Banking Systems summarizes its section on banking and credit developments 1929-36 with respect to the trading banks as follows (pp.92-93):

> "The depression first affected the banking system through the serious loss of London funds in 1929, which reduced the liquidity of the banks. They became involved in an effort to restore liquidity which lasted until 1931. In spite of their endeavours the ratios at the end of 1929 went to a point which they regarded with apprehension. Aggregate advances could not be reduced easily, and indeed increased until the beginning of 1930. In their own interest the banks had to support their old customers, especially primary producers, who were most affected by the fall in export prices. The banks severely restricted new lending and endeavoured to reduce advances, but there is no evidence that during the depression they forced repayment of their loans on an extensive scale. It was not until 1931, when treasury bill finance and government expenditure expanded their deposits and added to their cash, that the liquidity of the trading banks was restored almost as suddenly as it had gone. In this way, the loss of London funds and of gold from the banking system was offset, and the banks soon removed their restrictions on new lending. The improvement in the banking position came about much earlier than the general recovery in trade and industry. From 1932 to 1934, the banks attempted to expand their advances, but found at first little response from borrowers despite the added inducement of lower interest rates. Gradually, however, as recovery proceeded, the banks were able to find more borrowers. Additions to cash reserves and to deposits through treasury-bill finance practically ceased after 1932, and changes in the liquidity of the banks again became dependent chiefly on movements in London funds. By the end of 1935, the liquidity of the banks had been reduced, and in 1936 there were signs of a slowing down of advances. It was not until export prices rose sharply, and London funds increased from the end of 1936, that the banking position became more liquid."

In explaining why "additions to cash reserves and to deposits through treasury-bill finance practically ceased after 1932," the Royal Commission Report comments as follows:

> "Between 1929 and 1931, treasury-bills were taken up reluctantly by the Commonwealth Bank, which called a halt in the process at the beginning of 1931, because it feared the effects that mounting deficits would have on the monetary system. Even after the Premiers' Plan of June, 1931, the Bank appears to have been rather reluctant in undertaking the required expansion. It would seem that the Bank was inclined to regard treasury-bills much more as a method of assisting governments than as a method of expanding credit.
>
> From July, 1932, the Bank urged upon the Loan Council the desirability of funding treasury-bills by public loan, and in 1932-33 and 1933-34 succeeded in bringing about some reduction in the total issue by this means. The Board may have been more concerned to reduce the volume of short-term debt than to contract credit, but the operation of funding contracted credit in the same way as if securities had been sold on the open market. As the trading banks were in a very liquid position at this time, the

contraction of credit meant little to them, but if the amount raised and used for funding restricted the use of credit by reducing the amount raised below the sum which it was then desirable to spend on public works, the process would have retarded recovery. With the possible exception of the funding in November, 1932, it cannot be said that the funding actually carried out retarded recovery." (p.212)

"The rate of discount on treasury-bills has been controlled by the Commonwealth Bank, and the bank has secured the reduction of the rate from 6 per cent in 1929, which was in line with the overdraft rates of that year, to $1\frac{3}{4}$ per cent in January, 1935. Moreover, the Bank has been concerned to restrain any tendency for the issue of treasury-bills to increase beyond what it has considered to be a reasonable amount. This is shown, for example, by its decision in 1933 not to discount treasury-bills to finance public works, and by its policy in 1934 in regard to deficits and rediscount. Further evidence is to be found in the Bank's attitude towards funding. In July, 1932, the Bank Board took the view that a beginning should be made in funding the internal floating debt. When the Loan Council met in October, 1932, the Board, holding that the large volume of treasury-bills menaced its control of currency and credit, offered to underwrite a loan of £20 mm. at 4 per cent at par, of which £12 mm. was to be used for funding treasury-bills and the rest for public works. The offer was not accepted, but a loan of £8 mm. at $3\frac{3}{4}$ per cent at par, underwritten by the Commonwealth Bank in conjunction with the trading banks, was raised, half of which was used for funding treasury-bills and half for public works. During 1933, the Board continued to urge that the increasing volume of treasury-bills should be checked, and the Loan Council agreed that there should be a gradual funding of the bills by loans raised in the market as and when conditions permitted. Consequently, in November, 1933, £5 mm. out of a loan of £10 mm., and in June, 1934, £3.5 mm. out of a loan of £12 mm. were used for funding, but the amounts funded were practically offset by the issue of additional bills for revenue deficits. In October, 1934 the Bank Board proposed to the Loan Council that treasury-bills should be funded by means of a public loan, and in the alternative offered to fund £5 mm. of bills by private funding. The Loan Council, however, was unresponsive to this advice, and consideration of the question of funding by either method was postponed." (p.64)

It is thus clear that deliberate credit expansion was not a matter of general policy in Australia. The Royal Commission took the view that expansion of central bank credit should have come earlier. "It should have been undertaken as a matter of policy when there was a serious contraction in London funds at the end of 1929, and should have been continued on a larger scale in 1930 when there was a loss of gold from the Australian banking system." (p.212).

This last must, of course, be read in conjunction with the Commission's views on the exchange rate; expansion of

central bank credit would have taken the place of the gold which was exported; it would not have stemmed the flow of gold, but would in fact have accelerated it. The only monetary measure which, in the midst of credit expansion, could have halted the outflow of gold was exchange depreciation. As to this, the Commission remarks as follows (pp.213-4):

> "The movement in the exchange rate in January, 1931, was one of the major contributions of monetary policy to recovery in Australia. It increased the returns to exporters in terms of Australian currency which tended to increase the volume of export production, and it tended to restrict imports. Had the movement come earlier, the fall in the national income would have been less, and the task of recovery easier.
>
> The Commonwealth Bank joined the trading banks in 1929 and 1930 in resisting the movement of the exchange rate. The force of the tradition of equality with sterling was powerful, the reluctance of governments to add to their budget difficulties was great, and the fear of inflation and flight of capital was strong. The future of export prices and of prices generally could not be foretold. Weight had to be given to all these considerations, and there was some justification in 1929, and in the early part of 1930, for the Bank's attitude to the exchange rate. The arguments for a serious change in the rate were not as cogent as they were later; but, after the middle of 1930, it was unwise for the Commonwealth Bank and the trading banks to attempt to hold the rate.
>
> While it was a wise action in 1929 on the part of the Bank to recommend the mobilization of the monetary gold in Australia, and its use as a means of meeting overseas commitments, yet the attitude of the Bank towards gold tended to obscure recognition of the fact that Australia had departed from a gold standard.
>
> In the belated movement of the official exchange rate to 130 in January, 1931, the initiative was taken by the Bank of New South Wales. By that time, the Commonwealth Bank should have realized the value of exchange depreciation as a means of meeting an emergency, and have raised the rate to a height which would have restricted imports and maintained exports. In the light of events, a higher rate might have been justified, but actually the rate was determined by outside market quotations. The Commonwealth Bank, as the central bank, should have taken charge of the rate at that time, increased it, if necessary, and have been prepared to buy and sell freely. Then the Bank would have been in a better position to protect and to build up London funds as circumstances permitted, and to replace some of the international reserves (including gold) which had been used in the crisis. In December, 1928, these reserves in gold and London funds had amounted to some £90 m., but by December, 1930, they had fallen to about £40 m. But the Commonwealth Bank, in regard to the exchange rate, merely acted as an ordinary trading bank until December, 1931, when it assumed control, fixed the rate at 125, and began to buy and sell freely."

(iv) The Commonwealth Bank

Throughout the foregoing sections there have been repeated references to actions by the Commonwealth Bank, without any exposition of its status and powers. Prior to the depression, the Bank was not a central bank and only the rudiments of a central banking system existed. By the end of 1931, after a development compressed into little more than two years, the Commonwealth Bank had emerged as the dominant institution in a central banking system as fully developed as conditions in Australia allowed.

The Bank was established in 1911, by a Labour Government, as a government-owned trading bank and savings bank for the express purpose of competing with existing banks. It has been banker to the Commonwealth since 1913, Tasmania and Western Australia since 1914, South Australia 1916, and Queensland since 1920. The necessities of war finance gave to the Bank, as financial agent for the Commonwealth Government, an opportunity greatly to increase its powers and prestige. In 1920 the first step was taken towards becoming a central reserve bank, when a Note Issue Department was established, to which was transferred the control of the note issue, previously under the Commonwealth Treasurer. In 1924 the Commonwealth Bank Act was further amended, including provisions that, after a date to be proclaimed, the Bank Board should fix and publish from time to time the rates at which it would discount and re-discount bills of exchange; and, also from a date to be proclaimed, the banks should use the Bank as a clearing house for settlement of inter-bank balances. In neither case has the proclamation been issued. The first of these provisions has not yet been of importance in Australia, and the purpose of the second was subsequently achieved without legal compulsion.

The 1924 Act also effected a change in the management of the Bank by substituting control by a board in place of the previous control by a governor. The Board consists of

the Governor, who is the chief executive officer, the Secretary to the Treasury, and six others. The members are appointed by the Government and hold office for a term of years (retiring in rotation) a fact which in 1930 and 1931 rendered the Board independent of the Government since the latter was unable to secure passage through the Senate of legislation designed to impose its will on the Bank. The Chairman is elected by the Board.

In 1930 the Government introduced a bill to establish a Central Reserve Bank of Australia, the effect of which would have been to leave the Commonwealth Bank in the position of an ordinary trading bank and savings bank; the new central reserve bank was to be more directly under government control. The bill passed the House of Representatives, but was given six months' hoist by the Senate in April 1931.

Meanwhile, events had been moving towards development of the Commonwealth Bank as a central bank. Shortly after the passage of the 1924 Act the trading banks commenced to hold balances with the Bank, although the major part of their cash reserves was still held in the form of Australian notes and gold. Late in 1929, when the exchange situation was becoming critical, the government secured passage of a Commonwealth Bank Act which empowered the treasurer to authorize the Bank to obtain particulars of gold coin and bullion held in Australia, and to require the surrender of the gold for Australian notes. During the next six months the trading banks paid in nearly all their gold, taking payment therefor largely in the form of deposits with the Commonwealth Bank, but also partly, in the first instance, in Australian notes.

Until late in 1931 exchange control was exercised by the banks as a whole, with the trading banks seemingly taking the initiative in any changes that occurred, but the control was far from effective, the pressure of the "outside market" frequently forcing the banks' hand. In December, 1931,

however, at the request of the other banks, the Commonwealth Bank accepted full responsibility by establishing a price at which it would buy and sell freely. Except for the change from £130 to £125 Australian to £100 sterling in December 1931, the control has taken the form of preventing short term fluctuations that might otherwise have occurred. The internal monetary situation has consistently depended chiefly on the amount of the trading banks' London funds, which normally constitute the activating portion of their cash reserves. The Commonwealth Bank could control such funds only by alteration of the exchange rate, or by rather drastic changes in central bank credit sufficient to cause the trading banks so to expand or contract their advances as to alter the volume of imports and/or exports. Some action has been taken, but, as before the depression, internal monetary policy has been a somewhat passive partner in the relationship, with London funds, dependent chiefly on exports and world commodity prices, taking the active role. The Royal Commission Report (p.73) notes that the Commonwealth Bank's opinion is that all it can do to increase or decrease the credit base is to "add to or subtract from the effect that movements in London funds have on the credit base in Australia."

The Bank has power to purchase and sell securities on the open market, but has engaged in few open market operations. The objective of expanding or contracting the cash of the trading banks by such operations apparently cannot be achieved, because of the "sensitive and limited nature of the bond market," without affecting the price and yield of government securities, and ultimately interest rates generally. In 1935, however, action was taken through the Savings Bank to purchase securities for the purpose of offsetting the effect on interest rates of sales of securities by the trading banks.

Through its general banking department the Bank has some power to influence interest rates directly, which it would not otherwise possess in the absence of an internal

money market. Since 1930, however, as its central banking functions developed, the Bank has as a matter of policy restricted its trading bank activities, viewing them not as an objective in themselves but as "a favourable adjunct to central bank control in the power they confer to influence interest rates, to expand advances, if necessary, and to provide facilities which the trading banks may refuse or may not be in a position to supply."

During the depression the Commonwealth Bank exercised an important influence on public finance. The Bank persistently opposed exchange depreciation, and refused to expand credit or currency as desired by the government. It advocated drastic reduction in government expenditure, became the sole source of funds for government short-term borrowing (both Commonwealth and state) by arrangement with the trading banks, and finally (April 1931) set a limit to the amount of such borrowing. The government, unable to obtain inflationary action, had either to go through the steps leading to a dissolution of both Houses and appeal to the electorate, or default, or follow the course desired by the Bank. The compromise contained in the Premiers' Plan which resulted from this situation has already been described, as have the actions of the Bank after the adoption of the Plan. The Bank retained a measure of control, even when the Loan Council adopted a somewhat more independent viewpoint after the immediate crisis had passed, through the assistance it rendered as underwriter. On this point the Royal Commission said (p.62):

"Australian governments have sought to relieve unemployment and to hasten recovery by means of long-term internal loans for the purpose of public works. The Bank has acted as adviser to the Loan Council in regard to all loan finance. It is consulted by the Loan Council as to amount and terms of loans, and the time of issue; but the advice of the Bank has not always been taken. The Loan Council has always looked to the Bank to underwrite government loans in Australia, and the Bank has frequently proposed limits of underwriting which it has subsequently agreed to extend; but on the whole the Bank has been a most important influence in regulating public long-term borrowing. Between November, 1932, and November, 1936, all but one of the loans floated were underwritten by the Commonwealth Bank. The total amount underwritten was £84.3 mm. and, together with the Commonwealth Savings Bank, it subscribed £15.2 mm. to loans in the same period."

ROYAL COMMISSION ON DOMINION-PROVINCIAL RELATIONS

[Federal-state financial relations in [illegible]

REPORT OF PROCEEDINGS

AUGUST 8,1938

Official Reporter:

T. S. Hubbard

Parliament Buildings,
Ottawa, Canada,
Room 16, August 8, 1938

On Monday, August 8th, and on Tuesday, August 9th, the Commission heard Mr. L. F. Giblin, Professor of Economics at the University of Melbourne, Australia, former member of the Commonwealth Grants Commission, and one of the framers of the "Economists Plan" of 1931. Professor Giblin spent most of the time discussing the attached memorandum on Australia, and his comment on it is reported as follows:

"Ottawa, Ontario,
10.8.38.

"Dear Mr. Skelton:

I have read with care the memorandum on Federal-State Financial Relations in Australia which has been prepared for the Royal Commission on Dominion-Provincial Relations. It shows full and careful study of the original sources, the facts are set out accurately and the criticism expressed or implied is fair and reasonable.

The work has been done with great ability, and, with some minor amendments, which I understand are being made, I should regard it as a very satisfactory presentment of a rather tangled chapter of history.

Yours faithfully,

(Signed) L. F. Giblin"

It is unnecessary to reproduce the detailed discussion of this memo in the evidence. However, some of Professor Giblin's general comments may serve as an introduction to the study.

AUSTRALIA AND CANADA CONTRASTED

PROFESSOR GIBLIN: Federalism requires a certain measure of similarity in its members if it is to work reasonably well. It is desirable that there should be no great divergence either in political ideals or in social standards, or in economic strength in relation to population.

In considering the difficulties of federation in Australia, one has been impressed by the divergences, small indeed in political outlook, appreciable in social standards, but outstanding in economic strength. It does, however, seem possible within the framework of the constitution to make financial adjustments without great difficulty which will enable the machinery of federated governments to work efficiently.

Between the Canadian provinces the differences seem much more marked. I gather that there is general recognition of marked differences in the outlook of the population between the maritime provinces, Quebec, Ontario and the west -- differences in political ideals and, what is more serious, in political responsibility. There is nothing corresponding to this in Australia except a moderate slackening of political responsibility in Western Australia, which is now tightening up, and possibly in Queensland.

In social standards as expressed in social expenditure, the variations in Australia are serious enough to be troublesome. I get the impression of much wider divergences in Canada but have not the facts. I may say that I wrote out these notes roughly coming across in the boat and all I had with me was the 1937 Year Book of Canada.

THE ACTING CHAIRMAN: Would you mind making clear to us, Professor Giblin, what do you mean by political responsibility? You mentioned that particularly in connection with Western Australia.

PROFESSOR GIBLIN: What I mean is the attitude that is taken -- "this is our government and we have to make it work". That is the attitude.

THE ACTING CHAIRMAN: That is the meaning you give the words "political responsibility".

PROFESSOR GIBLIN: Yes. That is what I mean -- that attitude as opposed to the other feeling, "damn the government; let it do what it likes. It has nothing to do with me".

THE ACTING CHAIRMAN: Thank you; I do not wish to interrupt you.

PROFESSOR GIBLIN: As I was saying, I had with me only the 1937 Year Book. That was my only source of information, and I did not discover until I set out that it had little information on provincial expenditure. So that I have not very much to work on.

From the very incomplete data given with regard to the expenditure on education it appears that in some provinces expenditure per head of population is almost double what it is in other provinces; and if expenditure per unit of average attendance is taken, the divergences are equally wide. In Australia, the highest state expenditure per head is less than 20 per cent more than the lowest. That contasts with what seems to me almost double, from what I can gather roughly from the figures, in Canada. The Australian method of using one standard as a measuring rod works, not without creaking, for differences within the Australian range. For the Canadian differences it may be unworkable.

The same reflection occurs in a more fundamental matter, the differences in economic strength as a whole between provinces. I have no information as to relative taxable capacity by provinces and in its absence the most significant available figures are perhaps those for value of production per head. I have taken the figures for net production

per head. I have taken the figures for net production per head in 1935 from the official publication "Canada, 1938", page 25, and set beside them the Australian figures for the corresponding year. For Australia it is the mean of two years, 1934-35 and 1935-36, converted into dollars at $5.00 to the pound, for reasons noted elsewhere. Actually, the rate of conversion does not matter because it is only comparative.

The chief difference in significance is that the Canadian figures include "Construction," for which Australian figures are not available, and this item accounts on the average for five per cent of the Canadian totals. Thus Canadian figures might be five per cent greater than the Australian on account of the inclusion of construction under material production. We get for net production, per head, taking the 1935 figures I have obtained from Canada, $286 per head in Ontario, and the figures vary down to $124 per head in Prince Edward Island, with Saskatchewan, Manitoba and New Brunswick all just over $140 per head. So that for all these, not only for the small island but for these other provinces together, making a very substantial part of the dominion strength, production per head is only half that of Ontario. The figures for Australia I will take now.

If you take the same figures for Australia, turning them into dollars on that or any other basis, you get the highest figure in Western Australia of $273 and the lowest in Tasmania, $198. Instead of the highest being double or more than double the lowest, the highest is only about one-third greater than the lowest -- 37 per cent.

That does not tell the whole story, because material production does not in itself measure national income, and it will be noted that the highest figure in Australia is for Western Australia, a state which is asking for and getting

special assistance. There is evidence from other data that the income per head of Western Australia is just about the average of all the states and not very much greater than any.

It is obvious that the larger centres of population have the advantage in the production of services, which have to be added to material production. Many nation-wide commercial and financial activities will have their headquarters in Melbourne or Sydney, and with corresponding high incomes. The economies of mass retailing will be much more pronounced in the large centres, expressing themselves in high rents as well as large profits. The interest payments of the central government go more than proportionately to places like Melbourne and Sydney. But the chief correction to material production figures comes from the claims of other people in other states and abroad on the production of a given state.

The effect of these claims may be to add appreciably to the income of one state and reduce that of another. Exact information on these points is lacking in Australia, but it is possible to make a rough correction based on general knowledge, so that it will generally harmonize with other information about income. I have made a rough shot at this for Australia and then very rashly, but only tentatively and for illustration, made guesses from very imperfect knowledge of the corresponding corrections for the Canadian provinces. I have corrected the figures for Australia so as to make them a fairly sure measure of national income per head in the different states; and from the little I know of the Canadian provinces I have made corresponding adjustments of the same sort to show the position in Canada. These figures are more in the nature of an index number. I find that in Australia the highest are Victoria and New South Wales, \$260 -- I have expressed it in dollars -- and the lowest Tasmania, \$180. The difference is much the same, just 30 per cent, which we had in the crude figures, only,

instead of Western Australia having the highest figure, that now comes down to about the middle. Western Australia comes from \$273 to \$230 and Victoria goes up from \$248 to \$260. Similarly, New South Wales; and Queensland comes down a little. South Australia comes down rather more and Tasmania a little more still. The result is that from a rough estimate of national income per head we find that the richest state is only about a third greater than the poorest. Doing the same thing for Canada, the effect will be obviously to increase the disparity. Ontario will have a still higher figure than its crude figure of production per head, so that Ontario is raised from \$286 to \$300 and the Prairie provinces show a decrease. Saskatchewan and New Brunswick are \$130 and Prince Edward Island is \$110. So that the disparity is still greater than the crude figures of production per head suggest. Actually, the corrected figures I have are: Ontario, \$300; Quebec, \$215; British Columbia, \$210; Alberta, \$180; Nova Scotia, \$145; Manitoba, \$135; Saskatchewan, \$130; New Brunswick \$130; Prince Edward Island, \$110. You can do better than that when you have more information, but that is the kind of thing you will find.

The point is that income per head in the richest state is two and a half times, at any rate very much over two times, that of the four lower ones. I should have said province. The four lower ones, with a population of two and a half millions among them, are a very substantial part of the whole strength. For income per head in Australia, the highest figure is forty-four per cent greater than the lowest, and I am confident that this relation is roughly true. Corrections made on the same scale for Canada show variations over a very much wider range. The highest figure is nearly three times the lowest. Even leaving out Prince Edward Island there are three provinces at about the figure \$130 with Ontario having an income

per head more than twice as great. In Australia there is only one state seriously out of step and that only about twenty-five per cent below the average, and that state -- Tasmania -- is much the smallest with only three per cent of the total population

In Canada, there are four provinces, besides Prince Edward Island, containing twenty-five per cent of the population of Canada, with an income per head which I expect will be found to be less than half the Ontario figure.

Whatever corrections are made to my guesses, I suspect that the relations instanced above will substantially hold. They suggest that Australian experience must be very inadequate for the solution of the Canadian problem.

I did feel that the differences that seemed to stick out in standards of expenditure, and which certainly exist in income per head, make the whole problem of Confederation in Canada very different from that in Australia; and on that account methods which have worked in Australia might be quite unworkable here. It rather suggests, speaking vaguely, that a very much more fundamental handling of the situation is required.

In Australia it looks as if we could get over our difficulties within the framework of the present Constitution; they are matters that can reasonably be described as amenable to adjustments which will make the system work. Of course, we may be up against some snags -- economic bad luck for instance. On the whole we have had very good luck in Australia, and if we had a run of bad luck the system might not stand up against it. But taking normal expectations, it looks as if the thing might work in Australia with the kind of adjustments which the Grants Commission has made.

It does not seem to me to follow at all that anything of the same kind would be an adequate solution for Canada. That, of course, is just my own very vague feeling. The facts

do seem to point to the need for a much more fundamental handling of the problem, possibly much more far-reaching changes than have been found necessary in Australia.

MR. SKELTON: Had the variations in taxable capacity among the different states been substantial, larger transfers by the Grants Commission would not have solved the problem, or they would not have been possible on so large a scale?

PROFESSOR GIBLIN: That is my feeling, that it would not have been possible to make transfers on such a scale, and all the technical difficulties in computing them would have been very considerably increased. Errors that could be passed over when grants were comparatively small might involve enormous sums when the differences were so great. There would be much greater practical difficulty in getting the adjustments accepted. But more than that, as Mr. Skelton says, these transfers would be too large to be regarded as reasonable, and the conclusion would be, "Why not be one country at once and have done with it?"

MR. FOWLER: In Australia the responsibilities of the states for services are very much greater than those of the Commonwealth. The services rendered by the states are considerably greater than the services rendered by the Commonwealth. Is that right?

PROFESSOR GIBLIN: It is very hard to measure them. They actually spend more on them.

MR. FOWLER: What is running through my mind is this: In Canada the functions performed by the central government seem to be rather more widespread.

PROFESSOR GIBLIN: They are wider than in Australia, certainly.

MR. FOWLER: And the other factor is that the scale of subsidy payments in Canada is very much lower than the scale in Australia. I suggest that as indicating the possibility in

Australia of taking up considerably more of the difference between the highest and the lowest.

PROFESSOR GIBLIN: Yes, that is quite true. There are not such large activities to compensate.

MR. FOWLER: And we have not paid anything like the grants that you have given from the central treasury, so that there might be a range there for increase?

COMMISSIONER DAFOE: The matter of railway deficits in Canada is a dominion responsibility. The inference from your figures, Professor Giblin, would seem to be that distribution of subsidies on a per capita basis does not meet the situation.

PROFESSOR GIBLIN: Oh no.

COMMISSIONER DAFOE: Consequently there must be variations in the subsidies or you must have a substantial transfer of provincial burdens to the federal authority.

PROFESSOR GIBLIN: Yes.

COMMISSIONER DAFOE: You must take one road or the other.

PROFESSOR GIBLIN: If there are subsidies there must be great differences between them per head, very much larger than at present, though not so large as my figures suggest, in view of Mr. Fowler's point, that the actual functions of the provinces are not so great as in Australia. If you add the provinces to the municipalities there is, of course, not such a very great difference essentially. The railways at times have been profitable in Australia.

COMMISSIONER ANGUS: Would the figures for income be fairly steady from year to year, or are the incomes of some states exposed to variations, through world prices, greater than those of other states?

PROFESSOR GIBLIN: Yes, they are exposed to world

prices. On the whole you can say that these would be fairly steady over the last six or eight years. Probably in the twenties they would be different.

COMMISSIONER DAFOE: Those figures for the prairie provinces are abnormally low owing to drought and low prices for wheat.

PROFESSOR GIBLIN: Yes. It is a frightfully difficult question. I said that I expected the differences to go out in Australia with a moderate revival in wheat prices, but the future of wheat is extremely uncertain at the present time and, I am inclined to think, for a long period of years we shall have subnormal prices on the average.

COMMISSIONER ANGUS: I was considering the possibility of subsidies as a means of stabilizing conditions in two areas by benefiting one when it had a bad year and assisting the other in a year when conditions were unfavourable, and I was wondering whether the federal government could do anything in that direction?

PROFESSOR GIBLIN: Bad years are apt to be pretty general as far as prairie provinces are concerned.

Net production per head, 1935

Canada	$	Australia	£.A.	$
Ontario	286	West Australia	54.7	273
British Columbia	250	Victoria	49.5	248
Alberta	203	New South Wales	48.9	245
Quebec	198	Queensland	48.6	243
Nova Scotia	160	South Australia	44.4	222
Saskatchewan	140	Tasmania	39.6	198
Manitoba	144			
New Brunswick	143			
Prince Edward Island	124			
Average	220	Average	48.6	243

	Productn per head $	Adjusted index of income per head *		Productn per head $	Adjusted index of income per head *
Ontario	286	300	West Australia	273	230
British Columbia	250	210	Victoria	248	260
Alberta	203	180	New South Wales	245	260
Quebec	198	215			
Nova Scotia	160	145	Queensland	243	235
			South Australia	222	210
Saskatchewan	146	130	Tasmania	198	180
Manitoba	144	135			
New Brunswick	143	130			
Prince Edward Is.	124	110			
Average	220		Average	243	

Note: * This figure might be reduced, with the crude average made =100.

COMMONWEALTH GRANTS COMMISSION METHODS

PROFESSOR GIBLIN: Now, what I should like to emphasize is the fact that the Commission in Australia was fully conscious of the very great difficulty of establishing a "normal" standard of state government taxation and expenditure owing to the comparative fewness of the states and the great variations between them. No sort of average of non-claimant states could be expected to give a valid standard. It would be an average of three very diverse states, and the Commission had not the knowledge -- I do not know whether it is possible to obtain the knowledge -- to fix an objective standard, a standard that one would think a government ought to adhere to.

It is almost impossible to get any absolute standard of that kind. All attempts that have been made to establish theoretical standards -- for example, standards of wages, the living of wage earners -- have ended in results which were obviously very far from being of practical utility. The Commission, therefore, dismissed the possibility of making an ideal standard to which the state should conform. If there had been thirty or forty non-claimant states, probably an average would have been arrived at that would have been near enough for all practical purposes. But when there are only three, the variations that would take place in any one would so greatly alter the result as to render any standard unsatisfactory.

In effect, the Commission had to make a rather arbitrary decision as to standard, and they thought at the time that Victoria and Queensland -- Victoria being a rather economical and Queensland a rather expensive state -- would give, not the weighted average, but a fairly reasonable standard. If you took the weighted average by population instead of the aggregate average you got a different result. Including

New South Wales, a non-claimant state, you got a different result, and the differences would be substantial -- not enormous, but quite substantial. The Commission did not feel, therefore, that they had solved the question of determining what was a reasonable standard with which to compare other states. As noted in the attached study, in the Fourth Report, New South Wales was also used in calculating the normal standard, and the average of New South Wales, Victoria and Queensland sounds formally much better of course.

On page 53 it is remarked:

> "New South Wales was left out of consideration, in the more definitive and permanent methods adopted in the Third Report, as it 'exhibits so many disturbing features'."

We had to consider however more than the mere fact that New South Wales had been, perhaps for two or three years, running on rather peculiar lines as regards taxation and the provision of services. There was also the fact that it was impossible to ascertain with any certainty what the deficit in New South Wales was. New South Wales, of all Australian states, has an extraordinary skill in manipulating figures of finance, and there may be complicated transactions between revenue and capital expenditure -- transfers from and to the railways, transfers to and from trust funds -- which made it exceedingly difficult to ascertain what the real deficit in that state was.

New South Wales not being a claimant state, the Commission had no right to go to them and insist upon full particulars. They did not refuse to give us full particulars, but they always succeeded in answering the questions that were asked them in such a way as still to leave a loophole. One quite competent economist and statistician in Australia, after studying the position in New South Wales,

came to the conclusion that their deficit was very considerably out, even after the Commission had adjusted it by a million or two; and our investigations could not convince us whether he was right or wrong. As I say, there was always a loophole.

That, therefore, was really the reason why New South Wales was left out. The fact was put in that unprovocative form because we had no occasion to make trouble; but what had to be taken into consideration was more than the fact that New South Wales was above the "normal" standard. The trouble was the impossibility of satisfying ourselves at the time what the real New South Wales deficit was. Afterwards we did become convinced that they were really fairly right. In the succeeding year the Commission was able to satisfy itself that the figures were quite reasonable, and then it became possible to take New South Wales into the picture.

What I wish to emphasize is that the standard is admitted by the Australian Commission to be quite unsatisfactory. It is just a rough approximation and must depend upon the broad practical judgment of the Commission, looking at the three non-claimant states and putting them together in such a way as to furnish a fair standard; and it is obvious that three other people equally competent might make a somewhat different decision. A good deal does depend upon the competence of the members of the Commission to make practical judgments. The thing is dressed up in arithmetical terms as much as possible, and that perhaps is politically useful. But it must be admitted that in a good many instances the actual decision as to how much allowance must be made for this or that depends, not on the strictly arithmetical computation, but on the broad judgment of the Commissioners as to what is a reasonable figure.

COMMISSIONER MACKAY: Is there serious criticism on the part of the states of the standards laid down by the Commission, or of the Commission's arithmetic, in arriving at grants, or are the Commission's decisions generally accepted?

PROFESSOR GIBLIN: The people most interested are, of course, the people connected with the state governments -- the treasurers and a number of other people -- pleasant people -- who have been associated with the preparation of the case. They look through the reports carefully and criticize a number of points of detail, the actual calculations made, and they put up arguments to show that the calculations are wrong or unfair to the state which they represent. Those are matters that are always discussed personally with the Commission, and sometimes an adjustment is made on that account, and sometimes it is not. I believe, however, that on the whole they are rather convinced that they have a fair hearing and that the Commission does try to render a fair judgment. Of course, they are not always satisfied, but they are prepared to accept that judgment.

I do not believe that in any case there has been any sort of suggestion that they entirely repudiate this or that particular part of the calculation and absolutely protest against it. They might say, "We disagree with your calculation but we are prepared nevertheless to accept your judgment".

COMMISSIONER DAFOE: Has there been any indication of a disposition on the part of the non-claimant states to object to the whole procedure? Has there been any growth in such a sentiment?

PROFESSOR GIBLIN: I do not think so. Of course, there is a certain amount of objection all the time on the part of people who have not really thought about it, against any kind of grants to claimant states, by whatever method

given. On the whole, however, there is a widespread feeling that this method not being political is safer at any rate than any systematic method of giving grants, even though the grants are bigger. They see evidence that actually the Commission is moving under present conditions towards smaller grants. It has moved a certain way, and there is definite indication of further movement in the same direction. It is felt that if the thing had been left to chance, political pressure might have become intensified and the grants might have grown to all sorts of figures and assumed altogether undue proportions. Although it is recognized that these gramts are high, this method is regarded as safer, and there has been no criticism. There has been this suggestion, "Oh yes, that is all very well while the grants are going up. But what will happen when the grants are being reduced? Will the Commission be strong enough to reduce them in accordance with its principles?"

Well, that is really something that has yet to be proved.

MR. SKELTON: In calculating severity of taxation, is there any complaint about the formula used? You said that Tasmania had always been under the impression that it was the most heavily-taxed state, and according to your formula it turned out to be below average. Did they not object?

PROFESSOR GIBLIN: They really had not seriously considered the matter. That was obvious. As to the actual details of the taxable capacity and severity of taxation, that is open to a good deal of criticism. South Australia and to some extent Western Australia come back every year with further points which they make and which lead very often to some further consideration, some modification in detail. I do not believe they are having much difficulty in the final result, but you can go on almost indefinitely

finding more and more difficult points in matters where the calculations are not quite convincing and where more elaborate ones are expected.

MR. SKELTON: Have you complete information with regard to state incomes, so that taxation can be measured in relation to state incomes?

PROFESSOR GIBLIN: No; that is the trouble. If we had a complete measure of state incomes we could, on the basis of the states, formulate a standard system, something that would serve as a rough standard system of taxation, one which would not be definitely fixed but to which any graduation within certain limits would not make much difference. One could decide upon a system of taxation which would be a fair average Australian system and actually apply it to these incomes if one had the incomes definitely in income groups throughout the states. That would be the most satisfactory way of doing it, but we have not sufficient information about incomes. We ought to have it, but each state has a different system of income taxation and different ways of assessing income, so that their figures are not quite comparable. New South Wales has always refused to supply in any way any information in regard to their incomes, and that has been a great difficulty in getting information. So far as the federal government has been concerned, on the other hand, they have been very willing to give information, but their method of giving out information has been rather slow, so that they could not furnish the real information required with regard to net income. That question has been under discussion for some years and they are approaching the stage where they will be able to give real information about income. Owing to the high exemption, however, it may not be satisfactory.

THE ACTING CHAIRMAN: Are you speaking of the Commonwealth?

PROFESSOR GIBLIN: Yes. It may not cover the whole ground. The extraordinary thing about income taxation is that up until a few years ago the general feeling was, "There is no use trying to tax very low incomes; you cannot get anything out of them. You must make a fair exemption or the cost of collection is too much." Under the pressure of the depression, however, the Australian states did a most remarkable thing -- and I suppose other people did too -- for even New South Wales under a Labour government imposed a tax of a shilling in the pound on all wages, irrespective of the amount, and collected it.

COMMISSIONER DAFOE: Was there no minimum at all?

PROFESSOR GIBLIN: No minimum at all. All the states, besides the ordinary income tax, had some kind of special tax which began without any exemption at all. I believe that some states did have an exemption of £50 a year, or a pound a week, but some did not have even that, and stamps had to be paid for with all wages received.

COMMISSIONER DAFOE: The tax was collected at the source?

PROFESSOR GIBLIN: Yes. In the old days we said it was not worth trying to collect income tax because the administration would be too costly and no one would put up with it. But they did put up with it, even in New South Wales. It was Mr. Lang who put on this very rate of a shilling in the pound.

COMMISSIONER DAFOE: Was that the reason that it was accepted?

PROFESSOR GIBLIN: It was done in all states by different governments. Years before one would have dismissed it as not being practical politics.

MR. SKELTON: In view of the various qualifications necessary, some because of lack of information, others because

of the necessity of making more or less arbitrary adjustments for such things as utility and railway earnings, how accurate do you think your method of measuring the incidence of taxation in the different states really is? Is it more or less a matter of compromise between the states, and the adoption of whatever may be considered satisfactory, or do you feel that there is a scientific justification for it?

PROFESSOR GIBLIN: I believe that the calculations, to the stage to which they have been brought, do indicate the figure, but with a fairly wide margin of error. For example, if you came to the conclusion that the state was entitled to six hundred thousand, one could not say that that certainly meant anything more than that it was between five hundred thousand and seven hundred thousand. To some extent errors have been established and corrected, which would amount to fairly big sums. But they never all work in the same direction if you have a number of these things. Taking various alternatives, you could conceivably have an error considerably larger than £100,000 in £600,000 if all the mistakes ran the same way. However, my judgment is that it might run from five to seven hundred thousand.

The Commission has never tied itself to an exact arithmetical figure, but said it would take this as a basis and make a judgment upon it. Actually, if it is of the opinion, upon its general review, that £560,000 is due a state, and it feels that that is not enough, it will raise it a bit. It will generally, I am afraid, act a little bit dishonestly. It will give the state the benefit of the doubt on several statistical points in order to bring the figure up to £650,000. On the other hand, if it feels that another state which has come out at £800,000 is rather high, that it is really not in such a bad way as that, and having looked the situation over for a number of months and seen

the details, it will probably find some way of working that £800,000 down by £100,000. Though it is actually a matter of practical judgment, they will do it by giving the state the benefit of the doubt in a number of statistical things to cover up.

MR. SKELTON: Does any state never calculate with a view to giving itself the benefit of the doubt? How do you avoid argument on that?

PROFESSOR GIBLIN: They do not see all these details.

MR. SKELTON: And you do not have to give the details?

PROFESSOR GIBLIN: We say that our judgment is that the limit should be higher or lower as the case may be.

COMMISSIONER DAFOE: I do not think Australians are as combative as Canadians.

COMMISSIONER ANGUS: Have you had any difficulty from the standpoint of municipal deficits, and do you take that into account in considering the position of the state?

PROFESSOR GIBLIN: Municipal activities are very small, except in the case of public utilities, and they are generally self-supporting; such things for instance as water and trams.

COMMISSIONER ANGUS: Generally the municipalities have no large debts?

PROFESSOR GIBLIN: No.

COMMISSIONER DAFOE: The state looks after education?

PROFESSOR GIBLIN: Yes.

COMMISSIONER DAFOE: Is there any possibility of the need of these special grants disappearing in time?

PROFESSOR GIBLIN: Not disappearing, but getting very much less.

COMMISSIONER DAFOE: You are not inclined to think that they will disappear?

PROFESSOR GIBLIN: The grants to Western and South

Australia depend upon low wheat prices -- very low wheat prices -- and I do not know that the prospects of wheat prices being permanently high again are very good. I am inclined to think that after more or less trouble they will have to be stabilized at something which will make wheat growing profitable.

We are fairly satisfied that a lot of wheat growing in these country states of Western and South Australia can stand up against general world conditions and if wheat prices come to be stabilized at a fairly reasonable average figure, I believe that half the disabilities and difficulties of those states will disappear and the need for grants will disappear proportionately. They may be reduced to half what they have been in the last two or three years.

COMMISSIONER DAFOE: They will then be based largely upon the disabilities due to federal policies?

PROFESSOR GIBLIN: Disability due to seasons. At least half their trouble is attributable to abnormally low prices.

COMMISSIONER DAFOE: But supposing that were rectified, they would probably still advance a claim for consideration for conditions which might be interpreted as resulting from the operation of federal policies.

PROFESSOR GIBLIN: Oh yes; but their position with respect to actual need would be very much better. Half of it will disappear, possibly more. The needs of Western Australia will go entirely, supposing their gold production continues to increase, as it looks like doing.

COMMISSIONER DAFOE: Do you regard the Grants Commission as permanent, for the current generation at any rate?

PROFESSOR GIBLIN: Yes. It may not function under the same name, because it is proposed to merge it into

another body with a partly different personnel; but it will continue nevertheless. Of course, the new body may adopt new principles, but the work of the Grants Commission has now attained a certain momentum. The fact that the government has four times absolutely carried out its recommendations to parliament, the fact that it has accepted those recommendations with only isolated objections, and the fact that both parties feel that they are rid of a nasty question which they are able to put on to somebody else -- all this will tend, as long as they are moderately reasonable, to give greater and greater weight to the Commission's reports, with the result that they will become more and more automatic.

CONDITIONAL AND UNCONDITIONAL SUBSIDIES AND CONCURRENT LEGISLATION

COMMISSIONER MACKAY: Professor Giblin, will you be good enough to give us the benefit of any general observations you have to make, on the basis of your past experience in Australia, with respect to the subsidy system in general? A current criticism in Canada is that it is fundamentally unsound for one government to raise money and for another government to spend it. What is your view of that criticism?

PROFESSOR GIBLIN: That idea was advanced in some quarters at one time, and someone offered it as an excuse when the Commonwealth government desired to get rid of the obligation of paying twenty-five shillings a head to the states. It was at a time when they were feeling quite expansive and were looking rather admiringly at what was going on in the United States.

They were inclined to follow the example set by America At that time the United States governments were undertaking all sorts of activities, by means of grants, with respect to matters that did not definitely concern them under their constitution. They were providing money for education, health, forestry, and a variety of other things and thus securing a sort of influence over the states through the medium of subsidies.

Something of the same tendency manifested itself in Australia; the federal people there were smitten with the same idea. Your late visitor, Sir Earle Page, was infected with it too. They went into federal grants for roads, and they were obviously moving in the same direction in several other respects. Their idea was that instead of making any formal corrections of the position of the states it would be a rather nice thing for the federal government to play the part of a sort of fairy godmother and, by means of special

grants, to give compensation to suffering states. Consequently they wanted the greatest possible freedom in their finances and were therefore anxious to get rid of the per capita payments. Searching for a sound objective reason for it, someone invented the idea that it was a vicious principle for one government to raise money and another government to spend it, which I think is simply silly. I cannot see any justification whatever for it as a general principle.

To be sure, it is dangerous for one government to raise all the money which another government spends; but as long as a substantial amount has to be raised by its direct action, through taxation, there cannot be any temptation to the state to be extravagant simply because a part of its money is raised from another source. Wherever there are subordinate local governments, municipal governments, the world over, there is always a considerable proportion of a government's resources that comes from the central government, and I cannot see, in England, for example, that education suffers, or that the principle is vicious.

In a federal government the case seems to be still greater. I believe the federal government has long since given up the idea. I regarded it at the time as an ingenious invention for getting out of per capita payments, which they wanted to get rid of on other grounds.

MR. FOWLER: Do you think there might be objection to the principle if the amount of the contribution depended upon the spending unit's actions? Take the matter of unemployment relief, for example. If the scales of relief that were set by the junior units resulted in increasing the ultimate amount of the contribution from the senior unit, might not the contention have a valid application.

PROFESSOR GIBLIN: I do not think it is an argument against the principle that one government should provide another government with money. It is possible to discover ways whereby one government finds money for another which would be vicious and which would encourage all sorts of unhealthy conditions. The whole tenor of the Grants Commission's reports, the principle running through them, is to devise means of providing money for another government which would be free from the undesirable features suggested. Of course, in every direction there are possibilities of abuse and the object should be to avoid them.

COMMISSIONER MACKAY: Do I gather, that it is your opinion that grants-in-aid for particular services are undesirable -- for roads and health and education for instance -- and that the general subsidy, leaving autonomy to the state government, is preferable.

PROFESSOR GIBLIN: I think so. I think the state governments ought to be responsible and ought to be conscious of a real responsibility for the disposal of the revenues which they can raise, and in general it is perhaps not desirable to earmark them for special purposes. I do not know that that is an absolute objection.

COMMISSIONER ANGUS: Would you modify that in cases where it is desirable to have some sort of uniform standard for the country, while at the same time it is also desirable to have local rather than central administration?

PROFESSOR GIBLIN: Yes; I think it would clearly be reasonable then to provide the money for a specific purpose. It is rather difficult though to get real local administration without the financial responsibility for it.

COMMISSIONER ANGUS: I was thinking of things like public health grants and the cost of some particular service on condition that it conformed to certain standards.

PROFESSOR GIBLIN: I cannot see any objection to that. I should think that undoubtedly, if there were a great diversity of standards, it would probably be necessary to work on those lines; but where there was not too great a diversity I should be inclined to favour leaving it to the state to try the experiment, to try out its own ideas as much as possible. You would not desire to standardize services too much, I should think, between states or provinces. If they are to be states or provinces they must have individual responsibility and initiative in varying their administration. If the divergencies are too great it may be necessary to supply the money on the condition of a certain uniformity being adhered to, but that, I should think, would be in a case where the divergencies were rather extreme. If they were within moderate limits I should prefer to give the states a free hand.

COMMISSIONER MACKAY: But in practice, and despite the findings of the Grants Commission, Australia is adopting grants-in-aid for certain services -- health insurance for instance.

PROFESSOR GIBLIN: No, that is absolutely a matter of Commonwealth administration.

COMMISSIONER MACKAY: Oh, that is definitely within the administration of the Commonwealth?

PROFESSOR GIBLIN: Yes.

COMMISSIONER MACKAY: Constitutionally, does it not fall under the state?

PROFESSOR GIBLIN: No. As a matter of fact, both have powers in respect of health.

COMMISSIONER MACKAY: There is concurrent jurisdiction.

PROFESSOR GIBLIN: Yes, I should say so, as soon as you have admitted old age and invalid pensions. Those have always been accepted as matters falling within the jurisdiction of the Commonwealth.

COMMISSIONER DAFOE: But the state governments look after the health of the citizens of the states, do they not?

PROFESSOR GIBLIN: Yes. There are a great number of things on which either the state or the Commonwealth can work.

COMMISSIONER DAFOE: There is concurrent legislation, so to speak.

PROFESSOR GIBLIN: Yes; but where the Commonwealth does take it over the states drop it. Until the Commonwealth takes it over, however, the states carry it on.

COMMISSIONER DAFOE: In Canada there are one or two fields in which there is concurrent legislation, and then we have divided jurisdiction. Have you considerable difficulty with respect to the incorporation of companies? We have endless trouble about the control of companies.

PROFESSOR GIBLIN: The Commonwealth has power to deal with the matter, but so far it has not done so. It has been going to do it for a generation. The Commonwealth should have a general companies' law over-riding all state laws, and as soon as it has one the state laws will lapse. But it has never passed such a law.

COMMISSIONER DAFOE: The constitution provides for concurrent power.

PROFESSOR GIBLIN: Yes; that is one of the things on which the Commonwealth can legislate. There is, of course, nothing to prevent the states from legislating, except when the Commonwealth does pass an act the state legislation lapses. Divorce is another matter which is definitely under the Commonwealth. Under clause (32) of Section 51, it has the duty of legislating on marriage and divorce, but it has not done so, and in the meantime all the state laws differ. As soon as the Commonwealth produces a marriage law the state laws will lapse.

COMMISSIONER DAFOE: Insurance is a state matter, but the Commonwealth could step in and control insurance if it wished to do so.

PROFESSOR GIBLIN: Yes, without taking away anything from the states there are only very few things where the Commonwealth is given exclusive right, such as customs, excise and monetary matters. In most matters the Commonwealth is given the power to legislate but it is not bound to do so, and until it does the state laws hold. When it does legislate, the Commonwealth law over-rides the state law.

COMMISSIONER MACKAY: As I understand it, some progress has been made in Australia in the last year or two in the matter of unemployment insurance and health insurance. How has that been handled?

PROFESSOR GIBLIN: Health insurance is being handled by the Commonwealth, with the states taking part only nominally. It is running somewhat on the lines of the British system, availing itself of approved societies for carrying out its purposes. The Commonwealth will handle the finances of it entirely. Old age pensions form a part of the general system and the finances will be a purely Commonwealth matter. The states will collaborate to a certain extent in so far as actual health problems are concerned, but it will be almost entirely a federal matter. It will add considerably to federal expenditure. The unemployment thing is not going ahead, the Commonwealth having taken the view that this is a matter in which the states must assume a large measure of responsibility. They had conferences with the states but no agreement could be reached. The states were unwilling to take much responsibility and the Commonwealth insisted that it was actually a state matter. The states had dealt with unemployment in the past, and the Commonwealth felt that it could not go ahead unless the states were prepared to play. At present there is a stalemate on the subject. It may go ahead again but at the moment the government's hands are full with other matters,and it is probably prepared to

wait a year before taking up the unemployment question again.

COMMISSIONER DAFOE: I believe a new measure was introduced recently dealing with health insurance.

PROFESSOR GIBLIN: That measure is through both houses and is actually being administered at the present time.

COMMISSIONER DAFOE: Does the old age pension form a part of it?

PROFESSOR GIBLIN: It will work in as part of it; it will eventually be merged into it. This will be supplementary to old age pensions but after a certain number of years old age pensions will be provided out of the national fund.

COMMISSIONER DAFOE: Are old age pensions contributory?

PROFESSOR GIBLIN: No.

COMMISSIONER DAFOE: Is it intended to make them contributory?

PROFESSOR GIBLIN: Yes, but only to a comparatively small extent. The Commonwealth will be relieved of the additional cost of old age pensions, because that is coming about with the altered age incidence of the country. But they will still have to carry pretty well what they pay at the present time.

COMMISSIONER DAFOE: Has the federal government always paid old age pensions?

PROFESSOR GIBLIN: Yes.

AUSTRALIAN EXCHANGE POLICY

COMMISSIONER DAFOE: With reference to the Australian pound, when the depreciation took place was it the result of manipulation, so to speak, or did it result simply from allowing market forces to register in terms of values of Australian and English pounds respectively?

PROFESSOR GIBLIN: There was no deliberate attempt to do it. There was a good deal of advocacy of it, but at that time public opinion in Australia was not prepared to accept it. It was felt that it was cranky and academic and all that kind of thing, and it was pretty soon clear that it would not pay to try to put that over as a practical policy. People would be too much upset and would be distrustful of it. The actual facts forced it; that was really what happened. The relative demand for the two currencies had undergone a great change. Exchange was not available. English sterling exchange was not available and there were tremendous demands upon it from governments, importers and everyone else, and in the outside market they bid against it.

The banks have always tried to modify the fluctuations, and that is reasonable; otherwise there would be enormous seasonal fluctuations. When there is great demand for English exchange they ration it to some extent. They tell their importers, "You want fifty thousand; you must cut that to forty thousand, because we are short on exchange. You must do the best you can." In that way they have exercised very considerable pressure to limit the amount. In the earlier days, by simply moving from 100 to 102 or 103, with this kind of persuasive pressure it was enough to keep it in place. They tried all they could in that way to keep it down in 1930. It had been up to 103 and 104 in earlier years and no one worried about it, but it got beyond that, to 105 and 108, and that was getting beyond any variation which it had shown before. Then the outside market kept bidding against it.

The Commonwealth Bank took a very rigid attitude against it, and in my opinion it was quite wrong; it hung on to sterling much too long. Most people, university people at any rate, completely concurred in that thought, But there is something to be said on that side. Finally the Bank of New South Wales, the biggest trading bank, broke away. By agreement, the banks had fixed a rate and tried to hold it from time to time. They moved it to 108 and the Bank of New South Wales broke right away and in 1931 raised it to 115. Immediately the market went over that and in the course of two or three weeks there were repeated changes until it got to 130 and then the outside market stopped at that.

COMMISSIONER DAFOE: It was a natural movement?

PROFESSOR GIBLIN: The other banks had to come in and follow in a day or two.

COMMISSIONER DAFOE: Representations have been made to us on several occasions developing a theory pretty much along these lines - that the government of Australia depreciated the pound, or was instrumental in depreciating the pound, while conversely the government of Canada held up the dollar, and that therefore there is ground for a claim for compensation. That view has been very forcefully presented to us in some quarters. The government of Australia was not apparently a factor in bringing about that situation?

PROFESSOR GIBLIN: It was not a party to it, no. Actually at the time the government, I believe, certainly the Treasurer, would have liked them to have depreciated, but the Commonwealth Bank held itself quite free from any immediate influence from the Treasury. In fact, if the Treasurer had said anything it was likely to get its back up.

COMMISSIONER DAFOE: That was in the Theodore regime.

PROFESSOR GIBLIN: Yes; they were on bad relations with him. The Commonwealth Bank continued to throw their

influence against him. It was not supposed to be their particular job to fix the exchange rate. It was fixed by all the banks in conference, but so far as their influence went, they undoubtedly tried to hold on to sterling, and the actual change was brought about by pressure of events supplemented by the Bank of New South Wales. Neither directly nor indirectly, however, had the government anything to do with it.

COMMISSIONER ANGUS: Did it not eventually cease to be a market rate and become a fixed rate?

PROFESSOR GIBLIN: It has never been a market rate except in the long term sense. The Commonwealth Bank now tries to estimate at what rate, in the long term, having regard to the prospects of imports and exports for the next year or so, the balance can be maintained. They made a shot at 125 when they first took it into account - 125 Australian to 100 sterling - and that has fairly justified itself. There was strong advantage in keeping a fixed rate, and the object then was to make a shot at a rate which, over the next few years, would balance things. One cannot say that it was due to particularly good judgment; there was an element of luck in it, of course. The rate of 125 has, however, fairly well justified itself. Many of us thought at the time that 130 would have been better, and I still think so. It would have eased the position a little bit, but actually, at 125, we are able more or less to keep the balance. We have gone behind on balance of payments at some times, and at others we have gone in advance and built up reserves, but we are just about keeping an even keel without any strong tendency one way or the other. So that, as I say, 125 has been a fairly good shot at what the rate ought to have been, if you are going to keep it steady.

Obviously, in the ordinary course of events in any primary producing country, there is a season when exports are moving rapidly and there is any amount of overseas exchanges

available, and there are other times when imports are greater and the movement is the other way. It is the business of banking policy to even out the two, because you do not want the rate to jump up at one time of the year and to fall at another. We have always had good and bad seasons, and any bad season upsets the balance of payments. The idea, therefore, is to have sufficient reserves to carry over bad seasons without having to alter the rate of exchange.

Under the conditions of a primary producing country there is a great deal to be said for, and there are great advantages in having, as stable a rate as possible, and that has been admitted to be the aim in Australia, to try to keep a steady, long term rate. When something drastic happens, like a depression, which brings about a quite different relationship in prices - prices of raw materials and prices of finished goods and so on - it upsets the whole economy of the country, so much so that one is warranted in considering a new rate. Under such circumstances you have to fix a new rate, and the new rate, we feel, ought to stand and we ought to adjust ourselves to it until some very disturbing feature presents itself.

INTER-GOVERNMENT CO-OPERATION

COMMISSIONER DAFOE: Could you tell us in rather greater detail the extent of the co-operation between the states and the federal government by means of the Premiers' Conferences and other meetings of the same nature.

PROFESSOR GIBLIN: Yes; perhaps I might say something on that question.

COMMISSIONER DAFOE: Certain suggestions have been made to us which we have been considering. One is from the premier of Nova Scotia, that there should be a statutory meeting of representatives of the provincial governments and the Dominion once a year, and New Brunswick wants to have a sort of continuous contact between the federal government and the provincial governments. Our various studies show that in Australia this process of co-operation is well advanced.

PROFESSOR GIBLIN: We feel strongly on the point. We are quite convinced that federation will work only if there is a measure of understanding between the federal and the state governments. If they stick too closely to the literal letter of the law the position will always be rather difficult.

You must have a measure of co-operation, and we do not think that there is all the co-operation that there should be. We did get co-operation in connection with the Premiers' Plan, but that was under very great stress; there was great urgency in that case.

We do have very frequent meetings but the trouble is that these meetings are generally occasioned by some particularly burning question - for example, the amount of loan money which the different states will get. The premiers and the treasurers come along full of that subject, and having settled that question they soon show an anxiety to get back home. Though there may be on the agenda a dozen other items that really call for consideration they do not receive much attention. They do not get the consideration they deserve.

There are always a number of things in which co-operation and a measure of understanding between the governments are necessary. There are many things that ought to be discussed rather fully, but as a matter of fact they are not.

The suggestion has been made again and again, and one attempt was made to carry it out, to have a permanent secretariat for such meetings, an office which would keep going continuously and would prepare information on these points, circulating that information in advance, so that there would be some chance of the thing being intelligently discussed. And there is also a feeling that some pressure should be brought to bear to keep the premiers together for a sufficient length of time to afford proper opportunity for discussion. As it is, they simply settle the one question that is worrying them and give only perfunctory attention to others that are of some importance. The press is, however, down on secretariats and things of that kind and the governments have been a little shy of instituting anything of the sort. It is fairly certain, however, that a good deal of material needs to be digested and circulated in advance of the premiers' meeting; but the agenda is thrust before them and they have to deal with it without having previously given it very much study.

COMMISSIONER DAFOE: Who takes the initiative in calling these meetings?

PROFESSOR GIBLIN: The federal government, in general, but as a matter of fact it is no one's job in particular. Where it is a matter affecting the loan council, that is definitely the federal treasurer's job, and there is more done in that case. But the meeting very often turns from the loan council to something else; it resolves itself into a meeting of premiers, possibly with the same personnel, except for one or two changes. Mr. A will be a representative and Mr. B who has been sitting alongside him will cease to be one, but they both remain there.

COMMISSIONER DAFOE: They meet in different places, do they not?

PROFESSOR GIBLIN: No, in the same room.

COMMISSIONER DAFOE: I mean, in different centres.

PROFESSOR GIBLIN: Oh yes, they go from place to place.

COMMISSIONER DAFOE: One year they will meet in Adelaide and the next year in Melbourne.

PROFESSOR GIBLIN: Yes. Mostly they meet in Melbourne, and sometimes in Canberra and sometimes in Sydney. Melbourne is on the whole the most convenient meeting place, however.

MR. EGGLESTON: How many days does it take for a representative from Western Australia to reach the capital?

PROFESSOR GIBLIN: By rail it takes nearly four days, and that is one of the troubles. Now, however, they can come more quickly. They can fly, but they have not regularly adopted the technique of flying. They will soon and that will help things. The Western Australian, however, feels that he cannot afford it. It means losing three weeks to come and have a discussion and he cannot afford to do that. I believe the tendency is towards more and more agreement, and that will be very important in helping to make federation work.

COMMISSIONER DAFOE: What is the nature of the proposed Interstate Commission? What will be its scope and purpose?

PROFESSOR GIBLIN: No one knows exactly. They have not exactly told us, but the one definite job it will take on is the matter of Commonwealth grants. The idea was that it should take that on so that the personnel would be to some extent continuous. But there are several things to be considered. Originally the idea was rather that it should safeguard inter-state trade where it was being encroached upon by state action or by railway rates.

COMMISSIONER DAFOE: Is there much of that sort of thing going on?

PROFESSOR GIBLIN: Yes; one state tries to keep out another state's goods.

COMMISSIONER DAFOE: By what means?

PROFESSOR GIBLIN: By means of health inspection - the discovering of disease, and so on. That has been done, but it has been disallowed.

COMMISSIONER DAFOE: By the courts?

PROFESSOR GIBLIN: Yes.

COMMISSIONER DAFOE; The Commonwealth has no power of disallowance?

PROFESSOR GIBLIN: No.

THE LOAN COUNCIL AND THE COMMONWEALTH GRANTS COMMISSION

PROFESSOR GIBLIN: The loan council we regard simply as one of the means of getting coordination between the respective governments. It leads up to that. Actually, the loan council has very little power. Its chief power is to coordinate borrowing between states and Commonwealth and to arrange that the loan shall go out as a whole with the best prospect of success, and also to prevent one state getting ahead of another by absorbing all the money on the market and leaving the other at a loss. That was the original impulse behind it.

COMMISSIONER MACKAY: Has there been in fact much competition between states for loans? Was there much competition of that sort between the states prior to the establishment of the loan council?

PROFESSOR GIBLIN: There was a good deal. In the 20's it had been getting worse. While there was plenty of money available it did not matter so much, but as soon as supplies showed signs of getting short there was a good deal of scheming on the part of one government to get on the market first and obtain its loan before it was really wanted, and things of that kind. There was a real problem to be faced, and that was the impetus behind the loan council.

Obviously, if there were too many demands for loans, so that one was trying to get ahead of the other, that suggested the idea of some limit to the total borrowing of the states. The first requirement was to have every state indicate what it needed. You added them together and if they were of such an amount as you reckoned the market would supply, you would go ahead and borrow. Almost immediately, however, within a year or two, the amounts that the states required were more than there was any possibility of the market supplying. Then the London market dried up entirely, and after an interval in which nothing of that kind was done on the market,

the thing resolved itself into estimating the amount which could be raised on the Australian market for state and Commonwealth requirements.

The provision is that the loan council by a majority shall decide what is the maximum that can be raised, and then that has to be distributed among the states.

COMMISSIONER MACKAY: Do you mean the maximum that can be raised, or that ought to be raised in view of the needs of the states?

PROFESSOR GIBLIN: Each state indicates what its needs are. The loan council takes no cognizance of that. One state says it wants £3,000,000, and that is accepted; it is not examined in any way, nor is any question asked as to the way in which the money is to be spent. It simply says it wants £3,000,000. The next state says it wants so much, and so on, and these make a total of, let us say, £20,000,000. The question is: Can £20,000,000 be raised in the year on the Australian market? Nominally the loan council is supposed to make up its own mind on that and to decide whether the £20,000,000 can be raised or not. In effect they do not like risking a loan unless it is underwritten, but the only body in a position to underwrite is the Commonwealth Bank. So they go to the Commonwealth Bank and ask whether they will underwrite £20,000,000. If the Commonwealth Bank says it will not underwrite the £20,000,000, it is perfectly open to the states to go ahead and float £20,000,000, asking the Commonwealth Bank to manipulate the machinery, which, of course, it will do, and they take their chance on the market. They have only once attempted that, and it was quite successful. It was at a time when money was very plentiful and there was not much danger of its failing.

In general it has not been secured in that way, and it is rather coming to a question of how much they can persuade the Commonwealth Bank to underwrite. In this hypothetical case

they say they want £20,000,000. The Commonwealth Bank sizes up the market as best it can. It is obvious that if you are prepared to pay a sufficiently high rate of interest you may get any amount. It is always taken as assumed that the rate of interest must be very closely related to the last rate of interest paid. Supposing money was got at £3.15s at the last loan; you do not expect to vary more than a very few shillings from that in your rate of interest for the next loan. It is not a question of raising it from three and three-quarters up to five or six in order to get the money; it is assumed that the rate of interest which the Commonwealth Bank will underwrite is closely related to the current effective rates on government bonds.

Well, the Commonwealth Bank sizes up the money market as far as it can and decides that it will not provide £20,000,000 but only, say, £16,000,000 at that rate, and if you ask for more you will not get it. It is prepared as a rule to put a certain amount of money in, itself, to make up the deficiency, but not by a straight expansion of central bank credit in general to make up any substantial part of the £20,000,000 required. It gives the government its answer along that line -- or rather the loan council.

Generally there is great pressure to get rather more money. Each state, perhaps more for political reasons than for economic needs, wants as much loan money as possible, and there is a certain amount of discussion between the Bank and the loan council as to whether the Bank will not make a greater effort and stretch their judgment a little bit for an extra million or half a million. On that account there arose a good deal of bad feeling. The papers got hold of it, and of course they were lying in wait for something of the kind. At any rate they made the most of any difference of opinion that there was. Certain of the state premiers were not very responsible in the matter. They said, "We are under the

domination of the Commonwealth Bank. What sort of country is this when we set up a Commonwealth Bank that will tyrannize over us?"

A couple of years ago that state of feeling got rather bad. The papers wanted to stage a dog fight, as they very often do, and they made the worst of it from both sides. Some rather heated and intemperate statements were made by some of the state premiers. That feeling, however, has pretty well subsided in the last couple of years and there is now a more general tendency to recognize that the Commonwealth Bank is making the best estimate it can of the market and of how much money is available for borrowing for public purposes. It is also recognized that the Commonwealth Bank is itself making a moderate contribution towards the amounts required.

MR. EGGLESTON: Has there been any provision at any time for the federal government to guarantee state bonds if permitted to exercise some control over budgets?

PROFESSOR GIBLIN: There has been no question of controlling the budgets of the states. The nature of the control is this. The loan council controls the maximum amount borrowed, and that amount is borrowed by the Commonwealth on behalf of the states, whatever the amount is, and the states are under obligation not to go into the open market for any other loan.

MR. EGGLESTON: It prevents them from doing any borrowing on their own.

PROFESSOR GIBLIN: It prevents their doing any borrowing on their own, except that they are allowed to make arrangements to raise money in their own state from insurance companies, and so on. Whatever they do in that way counts as part of their loan programme. That is to say, if a state wants three millions altogether and a million is got by "domestic raisings", it only comes to the loan council for two million.

That was one side of the matter. The loan council

simply prescribes the maximum amount that can be borrowed. It is perfectly free to go ahead on that and borrow it. These controversies with the Commonwealth Bank are entirely an accidental side issue; they have nothing to do with the constitution of the loan council. The loan council has full power to decide how much can be borrowed, and then borrows it. It is just that they do not want to do it without having the loan underwritten and they ask the Commonwealth Bank to underwrite it. In the course of things there have been at times these controversies between the Bank and the loan council as to how much can be raised.

COMMISSIONER DAFOE: When you refer to "domestic raisings" does that mean that they are limited to their own state?

PROFESSOR GIBLIN: Yes; and in that they are limited to their own state they never amount to very much -- only a very small fraction of their requirements.

COMMISSIONER ANGUS: Is the limitation which the loan council decides upon based entirely on what the market will absorb, or does it take account of what it thinks it expedient that the state should borrow?

PROFESSOR GIBLIN: The loan council is composed of six state representatives and the federal representative. In general the states badly want to borrow money; they want as much as they can get. I do not say, at all times, but over the last half dozen years when money has been very difficult to come by. So that their outlook naturally is this: How much money can we possibly raise without increasing rates of interest?

I do not think there has been any question from the states' point of view of the amount being excessive. It may be a possible question at other times, but under the conditions of the last half-dozen years there has been perhaps no possibility of any very lavish borrowing. On the other hand, the Commonwealth, which has been in a very affluent position in the

last two or three years -- their revenue has been very much more than they wanted -- has not required money to the same extent. They have not attempted much in the way of public works, having been able to do almost what they wanted out of revenue, and consequently they have not been under the same pressure to get money. They, therefore, felt in the last two years that it would be better that government borrowings should be less. They accepted the principle that in the depression government borrowing was helpful towards recovery; but a year or eighteen months ago it became evident that we could not talk about depression any longer; we were moving rather towards boom conditions. In these circumstances, in accordance with the accepted theory that government borrowings should be more or less reduced to a minimum in order that they might be increased under conditions of depression, it was contended that the time of comparative prosperity was a time of reducing your debt as much as possible and establishing your finances on the strongest possible basis, building up internal revenues and pursuing all methods of that kind -- keeping taxation high, and, generally, putting yourself in as strong and favourable a position as possible to meet depression when it came.

Well, there was a little difference of opinion about that. Some people said, "We have really not recovered; we have still a lot of unemployment and we are only just beginning to recover. It is much too soon to talk about cutting down loan expenditure." So that there was some difference of opinion about it. But the federal government did undoubtedly adopt the view that we had got fairly well up in the upswing and that it was time to restrict government borrowing so as to be in a position to expand when times of depression came. They therefore exercised some influence towards keeping down the total amount of borrowing.

The matter is decided by a majority view, and the only questions that really arose were of this sort: Perhaps, instead of twenty millions they wanted twenty-two millions.

The Commonwealth Bank said they thought that twenty millions could be raised, and the question was, should they insist on having twenty-two millions which the Commonwealth Bank said that they were not prepared to underwrite. Only differences of that kind came into account.

Suppose you have one state that wants to spend very freely and to do it on a scale very much bigger than you find in other states, and there is a general feeling that it is too inflationary, that it is unnecessary inflation. Suppose there is a general feeling of that kind. The loan council cannot exercise any influence on this particular state or on what it gets; it can only influence the total amount that can be borrowed. Now, when you get your total amount you have to divide it among the states, and there is provision in the financial agreement that if there is not a unanimous agreement about the matter among the states, the proportion going to each state shall be determined automatically by its proportion over the last five years.

Suppose New South Wales, the largest state, wanted to expand very greatly, to borrow quite lavishly compared with the other states. It is entitled, let us say, on the basis of its borrowings, which have been heavy in the last five years, to forty per cent of the total. You can reduce New South Wales only by reducing everybody else's share at the same time. The loan council, that is to say, has no power to alter the proportions of different states. Supposing the amount required by New South Wales is too large. You can reduce it only by reducing your own proportion at the same time. So that it is not possible to interfere to any considerable extent with the finances of any particular state.

MR. SKELTON: How does that work in practice? Have there not been a number of complaints from a state like Victoria, say, which claims to be quite conservative in its borrowing, having set its requirements at the lowest figure

necessary, while some other state has asked for an excessive amount, that its own requisition has to be reduced in order to make possible the reduction of the amount asked for by the other? In practice, have you had to apply the previous year's quota, or has some compromise been possible?

PROFESSOR GIBLIN: Always, in fact, some compromise has been reached, but it is only because there is the automatic arrangement behind it. Actually, Victoria was in that position of being a very moderate borrower. As long as it continued to be a moderate borrower it was all right and wanted only a small proportion of the total and got it. But two years ago it changed its policy and decided to borrow a great deal more, and it found itself unable to do so. It could not get a proportion of the loan based upon its population proportion, which it felt was reasonable. It had to take a smaller share. It was strictly entitled only to a smaller share on the basis of previous borrowings. In that case some compromise was made.

Generally, there is a good deal of give and take, and an intermediate figure was agreed upon, which was rather more than Victoria was strictly entitled to under the automatic rule, though it was not as much as the state required.

Adjustments of that kind have generally fairly solved the problem. It did not in the case of Victoria, because that was the case of a sudden jump. A state which had been getting from year to year only £2,000,000 suddenly wanted £8,000,000, and obviously a little give and take on the part of the other states could not go very far towards bridging the gap between £2,000,000 and £8,000,000.

QUESTION: Could Victoria have put down a very much larger sum in the hope that the reduction would not go below the figure it actually required?

PROFESSOR GIBLIN: No. It would not make any difference what it would put down if the amount had to be reduced. It would only make this difference, that in talking it over

Victoria would go into details and say, "We want this money badly. We really do need it for this, and this, and this, which are all very good objects. You ought, therefore, to go some way towards meeting us." But what the state wants and why it wants it does not cut any ice -- well, it does cut a bit of ice in the compromise. Suppose Victoria said, "We want eight millions for this and that", and "this and that" seemed to be wild cat schemes that had not general public approval. In that case, other states would not go very far in meeting its demand for a larger loan. If, however, the request were a reasonable one, if it were something that all the others might be doing themselves, they would make a serious effort to reach a compromise and give Victoria substantially more than she was entitled to under the purely automatic agreement.

In this case the feeling was very bad and there was talk of scrapping the loan council, or amending its constitution or something of the sort. This difficulty about making the amount of the loan allocated to the states depend upon past expenditure was a weakness in the institution from the beginning. That was recognized by everyone concerned in the making of the financial agreement.

The financial agreement was a difficult thing to get through, and at the time New South Wales was very much inclined not to play with the rest of the states. It was sticking out at all points. Mr. Lang was inclined to fall out with the other states on general principle, and its actual technical treasury was not inclined to work with the other people. They made it difficult at every point, and a number of compromises had to be arranged in order to get any agreement through. They were in that strong position, having been very lavish borrowers in the past, and they said their economy, or their policy, demanded a greater loan expenditure than Victoria's did. They were therefore unwilling to give up that position and could only be brought in by means of the automatic rule whereby, if an agreement could not be come to otherwise, the amount should be made to depend upon the

borrowings for the last five years.

It is difficult to say how that can be amended until all the states which are borrowing a great deal really change their policy and say, "We do not want to borrow in the future". Then they might agree to give up the right.

COMMISSIONER DAFOE: Does the Commonwealth Bank do its financing in London?

PROFESSOR GIBLIN: This is all Australian.

COMMISSIONER DAFOE: The borrowing is all in Australia?

PROFESSOR GIBLIN: Yes, except that there has been one loan recently raised in London. That is the first one since 1929, the first long term loan, and that was for rather special purposes, to meet special conditions. It was only for £8,000,000, £ 3,000,000 of which was for defence purposes, defence equipment, and the object in floating it in London was largely to relieve the exchange pressure. Pressure was threatening on London funds -- there is a certain amount of pressure, although not very high, at the present time -- and it was obviously relieving them a bit if £3,000,000 instead of going to ordinary trade account, could be raised on capital account in London. And, as England was borrowing heavily herself for defence expenditure, it was a fairly easy loan to put through. The other five millions was required to fund some of the short term treasury bills in London, which were an obligation that came in 1930 when Australia had very great difficulty in meeting commitments in London. It raised the money on short term, which ultimately had to be taken over by the Commonwealth Bank. So that the Commonwealth Bank has in London today £30,000,000 of short term debt of the Commonwealth government, which is a dead asset. It cannot be used in any way. It is nominally money due in London, but it is due from the Commonwealth government and so is not available as London funds.

For a long time we had in view the possibility of funding that in London. The effect of funding it in

London is not to add to money in Australia in the ordinary way that exports would, but simply to add to the balances of the Commonwealth Bank in London. It does not go into the general banking situation.

A loan raised in London for public works goes into deposits of the Australian trading banks and is a basis for credit. But this funding of Commonwealth treasury bills would simply stay with the Commonwealth Bank, forming a basis of £5,000,000 in London against droughts and other catastrophes.

There was therefore a very strong case for London as a financial institution to provide the money because it was really insuring its own bonds with Australia and providing insurance against drought and low prices.

COMMISSIONER DAFOE: Has the volume of treasury bills that piled up during the depression been lessened by flotations at home?

PROFESSOR GIBLIN: Only this £5,000,000 issue. That is the first step. We have been trying to push it for two or three years and this is the first opportunity when everything was favourable for putting it over; and I expect there will be future ones of the same kind. In Australia there has been practically no serious attempt to reduce the floating debt.

MR. FOWLER: Have you found that the states have been able to find credit in a way that would not have been possible if there had been no loan council?

PROFESSOR GIBLIN: Of course, you can never actually prove that because they have not been able to try. At the time when the loan council was formed some of the states, particularly New South Wales, were very sniffy about it. They said, "We can probably borrow more cheaply than the Commonwealth can". And so we find in the Financial

Agreement a queer clause by which any state may be allowed by the loan council to borrow on its own, to issue its own securities externally, as long as the loan council approves of the terms and conditions of the loan. New South Wales was very sure of its position. They felt that they could do things better than the Commonwealth. They never actually tried, however; they never asked to be allowed to do it. It became very evident three or four years ago, when New South Wales bonds were marked down very low compared to those of any other state, that if it had attempted to borrow on its own it would not have got anything at all. It would have had to pay a high rate indeed.

Up to 1930 they were not sure that the credit of the Commonwealth was appreciably better than that of the states, but everyone is quite sure now that it is, that it would be very difficult for most of the states to get money on anything like such terms in Australia, and equally so in England, if it were a question of borrowing in England.

MR. SKELTON: How do over-the-counter "local raisings" work? What kind of security is issued?

PROFESSOR GIBLIN: It is Commonwealth security. It goes on slightly all the time.

MR. SKELTON: Sold in post offices and in small institutions?

PROFESSOR GIBLIN: It is sold at the treasury itself. I do not know really who gets it. To some extent the insurance companies and such people make use of it.

MR. SKELTON: It seems a curious provision. Why was it inserted?

PROFESSOR GIBLIN: It was one means of picking up a little money, and they were glad to pick it up wherever it came. People from day to day wanted to put money into

government securities and they preferred to go straight to the treasurer rather than on the market, and so save commission.

MR. SKELTON: It means in effect that the state treasury is allowed to sell Commonwealth securities to the extent that it can find a market for them?

PROFESSOR GIBLIN: Yes, but all that has to be taken into account in the allocation of money by the loan council. It does not get ahead to that extent. It is deducted from its actual requirements.

MR. SKELTON: Is it given a certain amount of securities which it can sell in that way?

PROFESSOR GIBLIN: Yes, and they form part of the allocation by the loan council. Suppose they raise £100,000 out of £1,000,000 by domestic raisings; then £900,000 comes from the loan council.

MR. SKELTON: It is a convenient method of distribution?

PROFESSOR GIBLIN: Yes.

MR. EGGLESTON: They obtain that part of the money earlier than they would if they waited on the loan council?

PROFESSOR GIBLIN: Yes.

COMMISSIONER MACKAY: What provision is there for the state paying their proportion? Suppose they default in respect of interest or principle; how is the Commonwealth protected? They apparently guarantee.

COMMISSIONER DAFOE: The securities are Commonwealth securities and the Commonwealth is responsible.

PROFESSOR GIBLIN: The states are committed to paying the balance of what is due to the Commonwealth. The Commonwealth itself makes payments of some £7,000,000 to the states, and instead of paying to the state it pays the interest. Then there is a balance due from the states on the amount which is not covered by that £7,000,000.

COMMISSIONER MACKAY: It has power to keep back the subsidy?

PROFESSOR GIBLIN: Yes.

COMMISSONER MACKAY: Enough of the subsidy to pay the interest?

PROFESSOR GIBLIN: Yes. The seven millions is not sufficient to pay all the interest on the state debt. The interest bill is considerably greater than the seven millions which the Commonwealth paid. Well, the states are in the most formal way committed to paying the Commonwealth the balance. The only instance in which any question has come up has been in the case of New South Wales. New South Wales did not say it was unable to pay; it refused to pay. As a matter of principle it was going to reduce interest on all bonds arbitrarily and the Commonwealth government immediately declared that it would pay the bonds in full, that it was morally if not legally bound to do so, that it would do so, and that it would collect the money from New South Wales.

There is a story given briefly in the attached study. It is a long story and I have not the full details in my mind. But the Commonwealth took serious measures to attach the revenues of New South Wales for payment of interest. It got out all kinds of orders instructing people who owed money to the government of New South Wales to pay it to the Commonwealth. It directed the banks to pay over balances and things of that kind, and Mr. Lang fought the issue. He got the balances out of the banks before the Commonwealth could get them and was putting up a considerable fight; but undoubtedly the feeling of the state was not behind him. He was rather going against the majority feeling. It did not ultimately come to the point of the Commonwealth collecting pound by pound the money required. What would have happened if it had gone on is a

matter of speculation. Mr. Lang, in the course of the campaign, proposed certain things which the Governor decided were unconstitutional and he was dismissed from office. There was an election and a new government came in with a majority, which made good the amount due to the Commonwealth government. But what might have happened remains doubtful. If under these conditions a state definitely decided that it would default, that it would not pay interest, either that it would not pay it at all or only a proportion of it, only up to three per cent, say, and if that state were resolved to carry out its decision, it is not easy to say what would happen. It would probably not come to a question of civil war, but certainly the business of the state would be extraordinarily upset and disrupted. But whether actually the money could be collected until the state gave in, I do not know. Probably the state would have a very bad time. The Commonwealth would not get its money for a long time, but the state would no doubt get tired first and agree to pay.

MR. SKELTON: You say that there was a moral, if not a legal, responsibility on the Commonwealth to continue servicing the bonds -- or at any rate that the Commonwealth took that view. Personally, I did not suppose that there was any doubt about there being also a legal responsibility. Are they not Commonwealth bonds regardless of whether the Commonwealth collects from the state or not?

COMMISSIONER DAFOE: Not those bonds; that is the old state debt.

THE ACTING CHAIRMAN: That was before the conversion; on the conversion the new securities were Commonwealth securities. As I understand it, at the present time practically the entire state debt consists of Commonwealth securities, so that there would be a legal obligation to pay.

PROFESSOR GIBLIN: There is a legal obligation to pay, but this was the point: the legal obligation was to the state. The state could demand that the Commonwealth should pay, but the legal position was not perfectly clear so far as the bondholder was concerned.

COMMISSIONER DAFOE: With respect to those bonds in question?

PROFESSOR GIBLIN: Yes. There was a legal technicality and so the Commonwealth said that irrespective of technicalities they accepted full responsibility for payment of the bonds.

THE ACTING CHAIRMAN: Actually, are the bonds the bonds of the Commonwealth under the new regime?

PROFESSOR GIBLIN: They are now actually the bonds of the Commonwealth.

THE ACTING CHAIRMAN: And so the Commonwealth is legally responsible.

PROFESSOR GIBLIN: I beg your pardon; I am a little out. It was the Australian debt that was converted, and all became Commonwealth bonds; but the overseas bonds were not. The borrowings in London by the states are still in the name of the states.

THE ACTING CHAIRMAN: Not Commonwealth bonds?

PROFESSOR GIBLIN: No. Only as they are converted do they become Commonwealth bonds. There is a great deal that has not been converted, and there would be still a large quantity of state bonds outstanding.

THE ACTING CHAIRMAN: The old debt.

PROFESSOR GIBLIN: Yes, for which the Commonwealth is responsible; but it is responsible only at the suit of the state and not at the suit of the bondholder.

There are one or two other things about the Commonwealth Grants Commission that perhaps I may discuss very briefly. They are not of the first importance but they are of some in-

terest, I fancy. You were asking me about how the states were taking the recommendations of the Grants Commission, and I said that the people who look in detail at these recommendations were comparatively few. That is so, for you do not expect these reports to be best sellers in the community.

What is noticeable is the agreeable feeling on the part of the people who put up the case for the state with the Grants Commission. The treasuries of the different states, all the various people that appear before the commission, business people and so on who take part in the presentation of the case, and those representing the Commonwealth have, over the last three or four years, got into good working harmony with the Grants Commission. There is no hostility at all between them.

Some of the states began by asking for more than they eventually got. A state might say, "We ought to have two millions; two millions a year is what we require to compensate us for all our disabilities." In the recommendations they are given, let us say, £1,000,000. Well, having once said that they must have £2,000,000 to compensate them for their disabilities they cannot go back on that, and so they come along each year insisting that they want £2,000,000. But the people concerned in the negotiations know perfectly well that they will not get £2,000,000; they are practically satisfied that they ought not to get £2,000,000; and so, although the state continues to press for £2,000,000, it accepts cheerfully the decision of the Commission which makes it £1,000,000, let us say. They are putting up all the fight they can to raise it on certain points, but they have to a very remarkable degree accepted the general reasoning of the Commission and they are prepared to work in with the Commission in every possible way.

This is not always true of the governments of the states concerned. The experience varies somewhat. Generally, in two of the states, the governments stand very much behind their

treasuries and are on very intimate terms with the Commission. In one of the states the government has remained rather aloof and has tried not to commit itself. It has said, "This is business". It appoints someone to conduct the case and then stands aside, and when the decision is given it says, "That's that. It is not satisfactory, but we will accept it." But it refrains from attacking it in any sense. Two other governments, as a rule, have taken this attitude, "Well, it is not all we wanted; we think we have made a case for more; but on the whole we accept the decision as a reasonable adjudication of our claims."

I want to stress the good personal feeling that exists between the people concerned in the discussion.

COMMISSIONER DAFOE: Do they present their cases privately, or are they public?

PROFESSOR GIBLIN: In the first instance the case is printed, covering anything from 50 to 150 foolscap pages.

COMMISSIONER DAFOE: And do they support it by oral argument?

PROFESSOR GIBLIN: Yes. What the Commission has always done has been to insist that everything must first be in writing. It gets a look at the formal case and all sorts of people come along to be heard. First, however, a memorandum must be put in. The Commission reads the memorandum and when the witness comes along he does not go through it. It is taken as read and that saves a great deal of time.

COMMISSIONER DAFOE: Do they all appear at the same time?

PROFESSOR GIBLIN: There is a sitting every week.

COMMISSIONER DAFOE: Do you go to the state?

PROFESSOR GIBLIN: Yes. You go to the state and sit for four, five or six days, sometimes more than that; the material is put in ahead, and you take the witnesses one by one. Sometimes a memorandum may be quite informative, not requiring discussion and you may have ten pages of evidence; you may be

able to dispose of your witness in ten minutes. Another may be more controversial, you may want to dig out figures, and so you may have your witness for a couple of hours.

MR. EGGLESTON: We used to hear in the press about the agitation for secession in Western Australia. Very little is heard nowadays about that. Has the appointment of the Grants Commission had anything to do with allaying that agitation?

PROFESSOR GIBLIN: I think it is due largely to other causes. It was clear that they would not get anything out of secession if they did secede, but undoubtedly the appointment of the Commission and the harmonious relations that have prevailed, together with certain other influences, certain things the federal government has done, for example, have all had their effect. The personnel of the Commission - both the original and the present one, - have all got on very well with the people with whom they have come in contact. Generally they have got their confidence and have established very good friendly relations, and I think that has been an element in making the thing comparatively successful.

MR. EGGLESTON: Quite apart from the money grants, the mere fact that the Commission travels around helps.

PROFESSOR GIBLIN: Yes, that helps a lot. They like you to take an interest in their troubles and to go and see them, and the Commission has always had fairly good general information. The people are pleased to know that their difficulties -- farming or manufacturing or whatever it may be -- are understood and that you are showing an intelligent appreciation of their problems.

COMMISSIONER DAFOE: What is the special equipment of the secretariat?

PROFESSOR GIBLIN: It is very small; it is run cheaply. There is a secretary, an under-secretary and an economist, and there are two or three typists. That is about all.

COMMISSIONER DAFOE: Do they work continuously?

PROFESSOR GIBLIN: Yes; and the Commissioners on the whole have done more work than one would usually expect. Apart from the Grants, they have done a fair amount of work on their own between meetings, individually and collectively.

There is one aspect of their work to which I might refer for a moment. I am not sure whether it has been particularly mentioned here. It is a small thing but it has been useful, and that is getting government accounts on a uniform basis. When the Commission started there were extreme discrepancies in the methods of treasury accounting and in the statistics given of government activities. For example, all the states, Tasmania and Western Australia particularly, had very faked budgets. They managed to produce a story showing that their budget was balanced when the unbalancing was up to twenty or twenty-five per cent. All sorts of things were worked in as revenue which ought not to have been so regarded, there was juggling with trust funds, and things of that kind. It put them at once in a difficult position. Here is a state coming along with an ostensibly clearly balanced budget; but as soon as the Commission examined it it found that, instead of being balanced, the budget was three or four hundred thousand pounds out. Obviously that put the state in a weak position. With the detection of this sort of thing there was an incentive to state the thing honestly. In fact, one or two of the states accepted the new idea with almost too much enthusiasm and tried to include all sorts of extraordinary items in their expenditure, making a bigger deficit than they actually had. But it was fairly easy to check that.

It did mean, however, that these three states almost immediately began to try to make an honest statement of their financial position. The result is you get a movement towards putting things down in a uniform sort of way and finally the Commission got out a questionnaire on public finance -- an elaborate thing consisting of a great many sheets.

The Commission went to all the states, not only to the claimant states, but to the others with a request to have these things filled in, and after some hesitancy all the states agreed to do it. They are getting much more uniform in statistics on public finance than they used to be in the past.

On the other side, things were wanted which required statistical supervision from outside in order to bring about uniformity. Take the question of social expenditure by the states -- education, charities and all that. There are all sorts of difficulties as to what to put in and what not to put in. There is the question of net expenditure, fees and things of that kind. In the regular Commonwealth statistics there was nothing adequate at the time. We drafted exactly what we wanted and put it to the Commonwealth Statistician. He took on the job and, as a part of his ordinary procedure, he now publishes this information with regard to social expenditure, which is given in the reports of the Commonwealth Grants Commission.

Several other things of the same description he has undertaken. He has undertaken now a really consolidated and uniform kind of municipal statistical information with respect to finance, which had been in a very rickety condition.

The Commission has been able to put to the Commonwealth Statistician the need for this particular form and the government has been behind it; so that the Commonwealth Statistician has been enabled to get such additional assistance as he required. He has readily recognized the desirability of getting this extra information, and in a number of ways the Commission has been useful in improving the statistics of Australia, apart from the question of bringing about greater uniformity in the matter of budget procedure. That, at any rate, has been quite a useful bit of work.

MR. SKELTON: You spoke of getting such accounts on a uniform basis.

PROFESSOR GIBLIN: Yes; we have been trying to do that.

MR. SKELTON: How large a staff do you need to tackle that job properly?

PROFESSOR GIBLIN: Just our own staff. It has really been a matter of getting the states to do it themselves.

MR. SKELTON: And they did it?

PROFESSOR GIBLIN: Yes. The three states making claims were anxious to do everything they could to assist us. We were rather closely in touch with Victoria, and they were keen on that. We had only to put it to them to secure their co-operation; and when you have enlisted the help of four states you can easily get the other two to come into line.

MR. SKELTON: Did you need accountants to travel round and advise the State Treasurers?

PROFESSOR GIBLIN: The Commission visits three of the State Treasurers and has sent its Secretary on special visits to Sydney and Brisbane to settle outstanding points. It could spend a little more time on matters of that sort, and as a matter of fact it should have a larger staff; but it has rather been trying to do the work with a minimum of expenditure.